UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

ROSENBAUM CAPITAL LLC, On Behalf of Itself and All Others Similarly Situated, Plaintiff, v. BOSTON COMMUNICATIONS GROUP, INC., KAREN A. WALKER and EDWARD H. SNOWDEN, Defendants.	No. CIV. A. 05-11165-WGY

SUPPLEMENTAL DECLARATION OF CLARK W. PETSCHEK IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS AMENDED CLASS ACTION COMPLAINT

I, Clark W. Petschek, hereby declare:

1. I am an attorney associated with the law firm of Wilmer Cutler Pickering Hale and Dorr LLP, counsel of record to defendants Boston Communications Group, Inc. ("BCGI"), Karen A. Walker and Edward H. Snowden (the "Individual Defendants"). I am a member in good standing of the Bar of the Commonwealth of Massachusetts, and I submit this Supplemental Declaration in connection with Defendants' Reply Memorandum in Support of Their Motion to Dismiss the Amended Class Action Complaint, filed herewith.

2. Attached hereto as Exhibit 1 are true and correct copies of the Jury Instructions, marked as Court Exhibit No. 2, and the Court's Notice regarding Exhibit No. 2, entered on May 16, 2005 in *Freedom Wireless, Inc. v. Boston Communications Group, Inc. et al.*, No. 00-12234 (D. Mass.).

3. Attached hereto as Exhibit 2 are true and correct copies of excerpts of Freedom

Wireless, Inc.'s Opposition to BCGI's Motion for Judgment as a Matter of Law, filed on April 18, 2005 in *Freedom Wireless, Inc. v. Boston Communications Group, Inc., et al.*, No. 00-12234 (D. Mass.).

4. Attached hereto as Exhibit 3 are true and correct copies of excerpts of Freedom Wireless, Inc.'s Reply in Support of Its Motion for Attorney's Fees and Enhanced Damages, filed on October 14, 2005 in *Freedom Wireless, Inc. v. Boston Communications Group, Inc., et al.*, No. 00-12234 (D. Mass.).

5. Attached hereto as Exhibit 4 are true and correct copies of excepts of the *Freedom Wireless, Inc. v. Boston Communications Group, Inc., et al.*, No. 00-12234 (D. Mass.) docket reflecting the Order denying BCGI's and Freedom Wireless Inc.'s Motions for Summary Judgment, entered on August 10, 2004.

6. Attached hereto as Exhibit 5 is a true and correct copy of the April 29, 1996 Memorandum and Order in *In re Chipcom Corp. Sec. Litig.*, No. 95-11114-DPW, slip op. (D. Mass. Apr. 29, 1996).

7. Attached hereto as Exhibit 6 is a true and correct copy of BCGI's April 17, 2002 press release entitled "Boston Communications Group Announces First Quarter Financial Results.

8. Attached hereto as Exhibit 7 are true and correct copies of excerpts from BCGI's 1st Quarter 2002 Earnings Conference Call, conducted on April 17, 2002.

9. Attached hereto as Exhibit 8 is a true and correct table reflecting BCGI's common stock prices for the period August 9, 2004 to August 18, 2004.

10. Attached hereto as Exhibit 9 is a true and correct copy of the Report and Recommendation Re: Defendants' Motion to Dismiss in *In re Cytyc Corp. Sec. Litig.*, Civ. A.

No. 02-12399-NMG, slip op. (D. Mass. Mar. 1, 2005).

I declare under penalty of perjury under the laws of Massachusetts that the foregoing is true and correct.

Executed this 10th day of February 2006, at Boston, Massachusetts.

/s/ Clark W. Petschek
Clark W. Petschek

EXHIBIT 1

Court Ex Z

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

* *

FREEDOM WIRELESS, INC.,
Plaintiff

v.

CIVIL ACTION NO.:
00-12234-EFH

BOSTON COMMUNICATIONS GROUP, INC., CINGULAR WIRELESS LLC, AT & T WIRELESS PCS, CMT PARTNERS and WESTERN WIRELESS CORPORATION
Defendants.

* *

JURY INSTRUCTIONS

A. The Parties and Their Contentions

This case is a dispute between the Plaintiff Freedom Wireless, Inc. and the Defendant Boston Communications Group, Inc. and the Defendant carriers, Cingular Wireless, LLC, AT&T Wireless PCS, CMT Partners, and Western Wireless Corp. Plaintiff Freedom Wireless owns both the '067 and '823 patents. The Plaintiff alleges that Defendant Boston Communications Groups's prepaid service bureau and Defendant carriers' use thereof jointly infringe the '067 and '823 patents. The Defendants deny this allegation and allege that the '067 and '823 patents are invalid for anticipation and obviousness. I will now set forth the rules of law that you are to apply in deciding the outcome of this case.

B. Instructions Regarding Patent Infringement

1. Description of a Patent

A patent is a document that consists of (1) a specification; (2) a claim or claims, which are part of the specification; (3) a drawing; and (4) an oath supplied by the applicant. The specification is essentially a description of the invention. The law requires that the specification of a patent give a written description of the invention that is clear, concise and exact, so that a person skilled in the art to which the patent pertains could make and use the invention.

The specification must conclude with one or more claims. The claims are numbered paragraphs which define, in words, the inventor's rights by marking the limits or boundaries of the invention claimed to have been invented. The claims of the patent must define the particular thing claimed to have been invented with precision so that the public will know what the thing is, and be able to avoid infringing the patent.

The claims are also important because only the claims of a patent can be infringed. Each of the claims must be considered individually. It takes infringement of only one claim of a patent for the patent to be infringed.

2. Presumption of Validity

In this case, the United States Patent and Trademark Office has granted two patents that are now owned by Plaintiff Freedom Wireless: the '067 and '823 patents. The law presumes, in the absence of clear and convincing evidence to the contrary, that

the Patent Office acted correctly in issuing the patents. Therefore, you must presume that each claim of the patents asserted in this lawsuit is valid.

3. Patent Infringement

Patent law provides that any person or entity which makes, uses, offers to sell, or sells, without the patent owner's permission, a product, apparatus, or method legally protected by at least one claim of a patent, within the United States, before the patent expires, infringes that patent.

A patent owner may enforce his right to exclude others from making, using, offering for sale, or selling the patented invention by filing a lawsuit for patent infringement. Here, the patent owner, Freedom Wireless, sued the Defendants, alleging that Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof jointly infringe claims of the '067 and '823 patents.

In determining whether a Defendant is liable for infringement of Plaintiff Freedom Wireless' patents, you should disregard whether the Defendant has entered into an indemnification provision with one or more of the other Defendants.

4. Only Claims Are Infringed

Before you can decide whether Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof infringe the '067 and '823 patents, you will have to understand the patent claims. The patent claims are the numbered paragraphs at the end of the patent. They describe and measure, in words, the

boundaries of the invention. In this case, Plaintiff has alleged that Defendant Boston Communications Group and the Defendant carriers have jointly infringed claims 10, 11, 12, 13, 14, 15, 16, and 18 of the '067 patent and claims 1, 2, 3, 5, 9, 11, 12, 15, 17, 19, 20, 27, 28, 29, 30, 31, 34, 35, 36, 39, 42, 53, 57 and 59 of the '823 patent. Each of these claims must be considered individually. To show infringement of a patent, Plaintiff need only to establish that one of a patent's claims has been infringed.

Only the claims of the '067 and '823 patents can be infringed. The written description in the specification and drawing portions of the patents cannot be infringed. It is error to read everything from the specification into the claims. It is also error to limit the claims to the exact description of the examples in the specification.

5. Dependent and Independent Claims

There are two different types of asserted claims in the '067 and '823 patents. The first type is called an independent claim. An independent claim does not refer to any other claim of the patent. An independent claim is read separately to determine its scope. Claims 10 and 15 of the '067 patent and claims 1, 9, 11, 15, 17, 19, 20, 27, 28, 29, 30, 31, 34, 35 and 42 of the '823 patent are the independent claims asserted in this case.

On the other hand, a dependent claim refers to at least one other claim in the patent and incorporates whatever that other claim says. Accordingly, to determine what a dependent claim covers, you must read both the dependent claim and the claim or claims to which it refers together. In this case, claims 11, 12, 13, 14, 16 and 18 of the '067

patent and claims 2, 3, 5, 12, 36, 39, 53, 57 and 59 of the '823 patent are dependent claims. All of these claims are dependent because they refer to another claim in the patent. For example, in order to determine what claim 11 of the '067 patent covers, then, you must read that claim together with claim 10.

Some of the claims in the '067 and '823 patents are broader than other claims. You are not to imply the limitations or words of the narrower or dependent claims into a broad or independent claim if the broader claim does not include the same limitations. One may infringe an independent claim and not infringe a claim that is dependent on that infringed claim, but the reverse is not true. Accordingly, a dependent claim cannot be found infringed unless the claim on which it depends has likewise been found to be infringed. For example, because claim 11 of the '067 patent is dependent on claim 10 of said patent, if you find that the Defendants did not infringe claim 10, you must also find that the Defendants did not infringe claim 11.

6. Two-Step Process for Determining Infringement

Determining whether an asserted claim of the '067 and '823 patents has been infringed is a two-step process. First, the claims must be interpreted to determine the scope and extent of the rights granted by the United States Patent and Trademark Office. Because patent law allows the inventor to use his own terms in describing his invention, the meaning of the terms in an asserted claim must be properly interpreted based on a patent's specification, the prosecution history, the prior art, and other evidence. Claim

interpretation is my job, and I will instruct you as to the proper interpretation of any disputed terms in the claims of the '067 and '823 patents.

The second step is to compare the claims, as properly construed, with the allegedly infringing product. It is your job to perform this second step. You must compare each asserted claim, as properly interpreted, with Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof.

7. Claim Construction

As I have already explained, claim construction is my job. You must determine, based on my interpretation of the claims, whether Boston Communications Group's pre-paid service bureau and the Defendant carriers' use thereof jointly infringe the '067 and '823 patents. I have recently construed the term "ANI," as used in the '067 and '823 patents. For the purposes of your deliberations, the term "ANI" means the cellular subscriber's number.

I will now hand each of the jurors a copy of the elements and construction of the claims of the '067 and '823 patents. These claims and their construction are hereby incorporated into my instructions.

8. Literal Infringement

A patent may be infringed in two ways, either literally or under what is called the doctrine of equivalents. The Plaintiff alleges that the Defendants jointly infringed the '067 and '823 patents both literally and under the doctrine of equivalents. In order to

infringe a patent claim either literally or under the doctrine of equivalents, the allegedly infringing product must include every limitation of the claim. This means that if you find that the Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof jointly infringe each and every element in an asserted claim of the '067 or '823 patents, you must find that Defendants jointly infringe that claim. On the other hand, if you find that Boston Communications Group's prepaid service bureau and the carriers' use thereof omit even a single element of an asserted claim of the '067 and '823 patents, you must find that Defendants do not literally infringe that claim.

I will now instruct you as to literal infringement. For the Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof to literally infringe any one of the asserted patent claims, the Plaintiff must prove by a preponderance of the evidence that the prepaid service bureau and its use thereof contain all of the claimed elements of the patented invention just as those elements are described in the claim language, either as I have construed that language for you or, if I did not construe it, in accordance with its ordinary meaning.

You may find that the Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof literally infringe the '067 and '823 patents even if the prepaid service bureau includes additional features not recited in the '067 and '823 claims. In other words, if you find that Boston Communications Group's prepaid

service bureau and the carriers' use thereof include each and every element set out in one of the '067 and '823 patent claims, a finding by you that the prepaid service bureau also includes additional components is irrelevant to the question of literal infringement of that claim.

Remember that the question you are to answer is whether the Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof jointly infringe any asserted claim or claims of Plaintiff's '067 and '823 patents. You must determine literal infringement by comparing the prepaid service bureau and the carriers' use thereof with each of the asserted patent claims individually. Accordingly, you must be certain to compare Boston Communications Group's accused system and the carriers' use thereof with the claims of the '067 and '823 patents only.

9. Infringement Under the Doctrine of Equivalents

As I mentioned earlier, a patent can also be infringed under what is called "the doctrine of equivalents." I will now instruct you on the doctrine of equivalents.

The doctrine of equivalents permits you to find infringement even if you were to find that the Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof fail to literally infringe the '067 and '823 patents. In deciding whether there is infringement under the doctrine of equivalents, you should consider whether or not Boston Communications Group's prepaid service bureau and the carriers' use thereof contain a step that is equivalent to any individual step of the asserted

claim that you find has not been literally infringed. In determining whether a step performed by Defendants is equivalent to a step of the asserted claim, you should determine if the step Defendants perform and the step in the claim perform substantially the same function, in substantially the same way, to achieve substantially the same result as the invention claimed in the '067 and '823 patents.

Under the doctrine of equivalents, Defendant Boston Communications' service bureau and the Defendant carriers' use thereof can infringe an asserted patent claim if it includes steps that are identical or equivalent to the requirements of the claim. If the Defendant Boston Communications' service bureau and the Defendant carriers' use thereof is missing an identical or equivalent step to even one requirement of the asserted patent claim, the Defendants cannot infringe the claim under the doctrine of equivalents. Thus, in making your decision under the doctrine of equivalents, you must look at each individual requirement of the asserted patent claim and decide whether the Defendant Boston Communications' service bureau and the Defendant carriers' use thereof has an identical or equivalent step to that individual claim requirement.

10. Joint Infringement

As I have explained, you must determine whether Defendant Boston Communications Group's prepaid service bureau and the Defendant carriers' use thereof infringe any claims of the patents of Plaintiff Freedom Wireless.

Under federal patent law, if separate companies work together to perform all of the steps of a claim of a patent, the companies are jointly responsible – that is, responsible as a group – for the infringement of the patent. Even if no single company performs all of the steps of a claim, the companies are jointly responsible. When infringement results from the participation and combined action of several parties, they are all joint infringers and jointly liable for patent infringement. Infringement of a patented process or method cannot be avoided by having another perform one step of the process or method.

Therefore, if you find that Defendant Boston Communications Group and the Defendant carriers have worked together to perform all of the steps of any claim of Plaintiff's patents, you should find that Defendants are jointly responsible for the infringement of that claim.

C. **Patent Validity**

Defendants claim that the asserted claims of the '067 and '823 patents are invalid on the grounds of obviousness and anticipation. As I previously instructed you, the patent is presumed to be valid.

It is the Defendants' burden to establish invalidity by clear and convincing evidence. Clear and convincing evidence is a higher standard of proof than the preponderance of the evidence standard I instructed you on previously. Clear and convincing evidence leaves no substantial doubt in your mind. It is proof that establishes in your mind, not only that the proposition at issue is probable, but also that it is highly

probable. Again, clear and convincing evidence is a more exacting standard of proof than proof by a preponderance of the evidence. However, clear and convincing proof is not as high a standard as "proof beyond a reasonable doubt," the standard applied in criminal cases.

1. <u>Prior Art Defined</u>

The prior art that has been introduced by Defendants into evidence in this trial with respect to the issue of the '067 and '823 patents' validity are the Klepp article from Telephony magazine, the Cominex invention, the Cominex brochure, the CSI reseller switch proposal, the Banana Cellular system that was on sale in November 1993 and described in the Wise patent (5,826,185), the Klotz patent (5,592,535), and the LinkUSA call processing system that was described in the Hogan patent (5,586,175). Plaintiff disputes whether the Cominex invention and brochure, the CSI reseller switch proposal, the Wise patent, and the Klotz patent constitute prior art.

Prior art means technology and information that was publicly known in the United States before the date of the invention, or described in an issued United States patent which was filed in the United States before the date of the invention, or as a prior invention in the United States that was not abandoned, suppressed, or concealed.

An invention made by another person before the inventors on the patent made the invention is prior art to the patent claim, unless that other person abandoned, suppressed or concealed his invention.

As a general rule, the first person to reduce an invention to practice is said to be the first inventor. An invention is reduced to practice when the invention is made and shown to work for its intended purpose. Thus, if another person reduces to practice an invention before the inventor on the patent, then the reduction to practice by the other person will be prior art to the patent claims.

There is, however, an important exception to this general rule. Someone who was first to conceive of an invention but reduced it to practice after someone else will be the first inventor if he was the first to conceive of the invention and he exercised "reasonable diligence" in reducing the invention to practice from a time just before the other person's conception. Conception of an invention occurs when the inventor has formed the idea of how to make and use every aspect of the patented invention, and all that is required is that it be made, without the need for any further inventive effort. Witness testimony by an inventor by itself cannot establish the date of conception. Reasonable diligence means that the inventor worked continuously on reducing the invention to practice. Interruptions necessitated by the everyday problems and obligations of the inventor or those working with him do not prevent a finding of diligence.

The final requirement for a prior invention to be prior art is that the prior inventor did not abandoned, suppress or conceal his invention. Generally, an invention was not abandoned suppressed or concealed if the invention was made public, sold or offered for sale, or otherwise used for a commercial purpose. The filing of a patent application that discloses the invention is evidence that the invention was not abandoned, suppressed or concealed. Here, the parties agree that the Cominex invention was not abandoned, suppressed or concealed; therefore, you need not consider this element during your deliberations as to the Cominex invention.

To establish the actual reduction to practice of a process or system that Defendants claim is prior art, Defendants, in this case, must prove two facts by clear and convincing evidence:

(1) that the prior art inventor performed a process, or constructed an embodiment of the prior invention; and

(2) that the prior art process worked for its intended purpose.

If you find by clear and convincing evidence that Defendants proved these two facts, then you should find that the invention is prior art. If you find that Defendants did not prove by clear and convincing evidence these two facts, then you should not find that the invention is prior art.

In addition, witness testimony, by itself, cannot establish the invalidity of a patent on the basis of prior knowledge, prior use, or prior invention. That is, witness testimony, by itself, cannot establish that an invention was known to, made by, or used by someone other than the inventors before the date of invention by the inventors on the patent;

These facts can be established only if witness testimony can be sufficiently corroborated by clear and convincing independent evidence. Sufficient corroboration by independent evidence is required, even if a witness has no interest in this suit, the parties to this suit, the subject matter of this suit, or otherwise.

I have one final point about prior art. Although the Cominex invention and brochure have been introduced as prior art, the patent application filed by Cominex, which was ultimately abandoned, is not prior art. As such, you should disregard any information that was shown to you from the abandoned patent application, and you should also disregard the testimony you heard about this Cominex patent application. This evidence has been stricken from the record and may not be considered in reaching your verdict.

2. Anticipation

Defendants have alleged that claim 15 of the '067 patent and claims 1, 27, 28 and 35 of the '823 patent are anticipated by the four introduced pieces of prior art, namely, the Klepp article from Telephony magazine, the Cominex invention, the Cominex brochure, and the CSI reseller switch proposal. As I instructed you earlier, the law presumes, in the absence of clear and convincing evidence to the contrary, that the Patent Office acted correctly in issuing the '067 and '823 patents.

In order for a claim to have been anticipated, you must find that the earlier invention completely embodied the same process as the patented claim and that all of the elements recited in the patented claim were previously found in exactly the same situation and united in the same way to perform the identical function. Put another way, each and every element of the patented claim must have been either inherent or expressly disclosed in a single prior art reference or a single prior art invention.

In determining whether every one of the elements of the claimed invention is found in the prior art, you should take into account what a person of ordinary skill in the art at the time of the filing of the patent application would have understood from his examination of that prior art.

For Defendants to prove that the subject matter of a claim of the '067 or '823 patents is anticipated by prior art, it is necessary that each and every element of that claim be found in a single prior art reference. Those prior art references must identically disclose or describe the subject matter of claim 15 of the '067 patent or claims 1, 27, 28

and 35 of the '823 patent with sufficient clarity to prove its existence in the prior art, or such disclosure should be inherent in the prior art reference. That is, a prior art reference may anticipate when a claim limitation not expressly found in that reference is nonetheless inherent in it. The word "inherent" in this context means that if the prior art reference necessarily and inevitably functions in accordance with the claimed limitation, it anticipates. To establish the actual reduction to practice of a process or system that defendants claim anticipates, defendants, in this case must prove two facts by clear and convincing evidence:

(1) that the claimed prior art inventor performed a process that contained all of the steps, or constructed an embodiment that contained all of the elements, of the claimed invention; and

(2) that the claimed prior art process or system worked for its intended purpose. To determine whether there is anticipation, you must compare each and every element of claim 15 of the '067 patent and claims 1, 27, 28 and 35 of the '823 patent to the prior art to determine whether all of the elements of said claims are disclosed or described with sufficient clarity within that single piece of prior art.

You may not combine two or more items of prior art to make out an anticipation. In this case, you may only look to the four pieces of prior art individually to determine whether there is anticipation. If a claim is anticipated by a single prior art reference or a single prior art invention, it is invalid and cannot be infringed.

3. Obviousness

An inventor is not entitled to a patent if his invention would have been obvious to a person of ordinary skill in the field of the invention at the time the invention was made.

The question is, would it have been obvious for a skilled person who knew of the prior art to make the claimed invention. If the answer to that question is yes, then the patent claims are invalid. Defendants have the burden of proving by the clear and convincing standard that the asserted claims of the '067 patent and '823 patent are invalid for obviousness.

Obviousness is determined from the perspective of a person of ordinary skill in the field of the invention. The issue is not whether the claimed invention would have been obvious to you, to me as a judge, or to a genius in the field of the invention. Rather, the question is whether or not the invention would have been obvious to a person of ordinary skill in the field of the invention.

In deciding obviousness, you must avoid using hindsight. That is, you should not consider what is known today or what was learned from the teachings of the patent. You must

not use the patent as a road map for selecting and combining items of prior art. You must put yourself in the place of a person of ordinary skill at the time the invention was made.

You must also keep in mind that the test for obviousness is not whether or not it would have been obvious to try to make the invention, but, rather, whether or not the

invention would have been obvious to a person of ordinary skill in the inventor's field at the time the invention was made.

In determining whether or not these claims would have been obvious, you should make the following determinations:

First, what is the scope and content of the prior art?

Second, what differences, if any, are there between the invention of the claims of the patent and the prior art?

Third, what was the level of ordinary skill in the art at the time the invention was made?

Fourth, are there any objective indications of non-obviousness?

Against this background, you must decide whether or not the invention covered by the asserted claims of the '067 patent and '823 patent would have been obvious.

I will now describe in more detail the specific determinations you must make in deciding whether or not the claimed invention would have been obvious.

Prior art means technology and information that was publicly known in the United States before the date of the invention, or described in an issued United States patent which was filed in the United States before the date of the invention, or as a prior invention in the United States that was not abandoned, suppressed or concealed, including the material that was before the patent examiner. The prior art that has been introduced into evidence in this trial with respect to the '067 and '823 patents' validity are the Klepp article from Telephony magazine, the

Cominex invention, the Cominex brochure, the CSI reseller switch proposal, the Banana Cellular system that was on sale in November 1993 and described in the Wise patent (5,826,185), the Klotz patent (5,592,535), and the LinkUSA call processing system that was described in the Hogan patent (5,586,175).

Second, in determining the differences between the invention covered by the patent claims and the prior art, you should not look at the individual differences in isolation. You must consider the claimed invention as a whole and determine whether or not it would have been obvious in light of all the prior art.

In deciding whether to combine what is described in various items of prior art, you should keep in mind that there must be some motivation or suggestion for a skilled person to make the combination covered by the patent claims. You should also consider whether or not the prior art "teaches away" from the invention covered by the patent claims. The question to be answered is this: Would someone reading the prior art be discouraged from following the path taken by the inventor?

Third, I have referred in these instructions to a person of ordinary skill in the art. What do I mean by such a person? The person of ordinary skill is a hypothetical person at the time of the filing of the patent application, who is presumed to be aware of all pertinent prior art. The skill of the actual inventor is irrelevant because inventors may possess something that sets them apart from the workers of ordinary skill in the art.

Fourth, you must also consider what are referred to as objective indications of non-obviousness. Some of these indications are:

1. Commercial success of products covered by the patent claims or made by a process covered by the patent claims.
2. A long-felt need for the invention.
3. Failed attempts by others to make the invention.
4. Copying the invention by others in the field.
5. Unexpected results achieved by the invention.
6. Praise of the invention by the infringer or others in the field.
7. The taking of licenses under the patents by others.
8. Expression of surprise by experts and those skilled in the art at the making of the invention.
9. The patentee proceeded contrary to the accepted wisdom of the prior art.

The presence of any of these objective indications may suggest that the invention was not obvious. The objective indications are only relevant to obviousness if there is a connection, or nexus, between them and the invention covered by the patent claims. For example, commercial success is relevant to obviousness only if the success of the product is related to a feature of the patent claims. If the commercial success is the result of something else, such as innovative marketing, and not to a patented feature, then you should not consider it to be an indication of non-obviousness.

As a final note about obviousness, during the trial you viewed some video testimony from an inventor named Steven Hogan about his patent and his company, LinkUSA. As I have already instructed you, Hogan's patent, which is called the '175 patent, has been introduced as prior art and may be considered by you in determining whether or not the claims of the '067 and '823 patents are invalid for obviousness.

However, I instruct you that any opinions offered by Hogan about how the technology in his patent could have been used with or combined with other technologies were inadmissible, have been stricken from the record, and may not be considered by you in reaching your verdict. This relates to opinions on obviousness. Similarly, any assertions or opinions offered by Hogan about any systems he claimed to have implemented were also inadmissible, have been stricken from the record, and may not be considered by you in reaching your verdict. This relates to the prepaid system he claimed to have implemented in a hotel.

The other portions of Hogan's testimony, however, were proper and may be considered by you in reaching your verdict. That testimony concerned LinkUSA, a company that provided a call processing system, and an advertisement placed by the company. Hogan testified about certain features the advertisement disclosed and how the system worked. Hogan also testified that he had obtained a patent on the LinkUSA call processing system, and he explained portions of the patent.

D. <u>Damages</u>

1. <u>Compensatory Damages in General</u>

If, after considering all of the evidence and the law as I have stated it, you decide that the '067 and '823 patents are infringed and are valid, the Plaintiff is entitled to

damages for the Defendants' joint infringement.

The patent laws specifically provide that when infringement is found, the plaintiff shall be awarded damages adequate to compensate for the infringement. The goal of patent infringement damages is to put the patent owner in the same financial position it would have been in had there been no infringement. As such, you may not include any additional amount for the purpose of punishing the Defendants or setting an example. In addition, you may not include damages that are speculative, only possible, or based on guesswork.

In this case, the award of damages, if any, must be calculated based on a reasonable royalty for the period of infringement by the Defendants. If you find that the '067 and '823 patents are not infringed, your verdict should be for the Defendants and you need go no further in your deliberations.

The fact that I will now turn to the issue of how you should measure damages should not be taken by you to mean that the Court believes that there was an infringement. I am instructing you on damages so that you will have guidance should you decide that Plaintiff is entitled to recovery.

2. Reasonable Royalty

A reasonable royalty is the amount of money a willing patent owner and a willing prospective licensee would have agreed upon, at the time of the infringement, for a license to make, use, or sell the invention. That is, the amount of money that would be agreed to in a hypothetical arms-length negotiation in which the parties in this case are operating

under the assumption that the patent to be licensed is valid, enforceable, and infringed by the Defendants, and that the parties in this case had been reasonably and voluntarily trying to reach an agreement.

In determining a reasonable royalty, you should place yourself at the point in time at which you believe the arms-length negotiation to which I just referred would have likely occurred. In this case, the appropriate point in time to consider is February/March 1998. If you find the '823 patent is infringed and not invalid, but the '067 patent is not infringed or is invalid, the hypothetical negotiation could have been no earlier than December 5, 2000.

In determining the amount of the reasonable royalty, some of the factors that you should consider are:

1. The royalties received by Plaintiff for the licensing of the '067 and '823 patents.

2. The rates paid by licensees for the use of other patents comparable to the '067 and '823 patents.

3. The nature and scope of the license, as exclusive or non-exclusive, or as restricted or non-restricted, in terms of geographic territory or with respect to whom the system may be sold.

4. Any established policy and marketing program of the Plaintiff to maintain its exclusive rights to its patents by not licensing others to use the invention or

by granting licenses under special conditions designed to preserve those exclusive rights.

5. The commercial relationship between the Plaintiff and the Defendants, such as whether they are competitors in the same territory and in the same line of business, or whether they are inventor and promoter.

6. The effect of selling the patented specialty in promoting the sales of the Defendants' other services, the existing value of the inventions to the Plaintiff as a generator of sales of its non-patented items, and the extent of such derivative or convoyed sales.

7. The duration of the patents and the terms of the license.

8. The established profitability of the systems made under the patent, its commercial success, and its current popularity.

9. The utility and advantages of the patented system over the old means and/or methods, if any, that had been used in the industry.

10. The nature of the patented invention, the character of the commercial embodiment of it as owned and used by the Plaintiff, and the benefits to those who have used the invention.

11. The extent to which the Defendants have made use of the invention, and any evidence probative of the value of that use.

12. The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the

invention or analogous inventions.

13. The portion of the realizable profit that should be credited to the invention as distinguished from non-patented elements, business risks, or significant features or improvements added by the infringer.

14. The opinion testimony of experts.

15. The amount that the Plaintiff and the Defendants would have agreed upon if both parties had been reasonably and voluntarily trying to reach an agreement. That is, the amount which a prudent licensee – who desired as a business proposition, to obtain a license to make and sell the invention – would have been willing to pay as a royalty and yet be able to make a reasonable profit.

To calculate reasonable royalty damages, you must first determine the reasonable royalty rate. The Plaintiff argues that the reasonable royalty rate should be a fixed number of cents per minute. Defendants argue that the reasonable royalty rate should be a percentage of revenue. To calculate the reasonable royalty damages, you must multiply the reasonable royalty rate, as determined by you in accordance with these instruction, by the total number of minutes or revenue.

E. <u>Willfulness</u>

The Plaintiff Freedom Wireless contends that Defendant Boston Communications Group committed the act of infringement willfully. The purpose of your determination of

whether Boston Communications Group infringed willfully is to aid the Court in making decisions that it will thereafter be called upon to make.

You must determine whether Plaintiff has proven willful infringement by clear and convincing evidence. As I described above in the patent validity section, clear and convincing evidence is a higher standard of proof than the preponderance of the evidence standard I instructed you on previously. Clear and convincing evidence leaves no substantial doubt in your mind. It is proof that establishes in your mind, not only that the proposition at issue is probable, but also that it is highly probable. Again, clear and convincing evidence is a more exacting standard of proof than proof by a preponderance of the evidence. However, clear and convincing proof is not as high a standard as "proof beyond a reasonable doubt," the standard applied in criminal cases.

The Plaintiff can establish willful infringement by proving two things: first, that Defendant Boston Communications Group was aware of Plaintiff's patent rights; and, second, that Boston Communications Group had no reasonable good faith basis for concluding that it did not infringe the Plaintiff's patents. The Plaintiff may also establish willful infringement by proving that Boston Communications Group did not exercise due care to determine whether or not it was infringing the '067 and '823 patents after it had actual knowledge of Plaintiff's patent rights. The test is whether a prudent person would have sound reason to believe that the patents were not infringed or were invalid or unenforceable, and would be so held if litigated.

In determining whether infringement is willful, you should look at all of the surrounding circumstances. One factor you should consider with respect to Defendant Boston Communications Group's good faith and due care is whether it obtained and followed a competent legal opinion from an attorney soon after becoming aware of the '067 and '823 patents. A competent legal opinion means an opinion based on reasonable examination of the facts and law relating to the issues of the validity of the '067 and '823 patents and the infringement of Boston Communications Group. A good faith opinion is also one that is prepared in conformance with the standards and practices generally followed by competent lawyers. Moreover, you should consider whether Boston Communications Group actually relied upon and followed the legal opinion.

Another factor in determining whether Plaintiff has proven that Defendant Boston Communications Group willfully infringed the '067 and '823 patents is your assessment of whether or not it copied the invention covered by the '067 and '823 patents. This is evidence tending to show willfulness. On the other hand, if Boston Communications Group tried to match Plaintiff's commercial product with a functionally competitive system but did not set out to copy Plaintiff's inventions, that is evidence tending to show that any infringement by Boston Communications Group was not willful.

The examples I have just given you, legal advice and copying, are but two factors you should consider. You are instructed that no factor by itself requires a finding of willful or non-willful infringement. In other words, your decisions with regard to legal

advice and copying do not mandate any particular conclusion on willfulness. Rather, in considering whether Defendant Boston Communications Group's infringement was willful, you should consider the totality of the circumstances and all of the evidence demonstrating its intentions.

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

* *

FREEDOM WIRELESS, INC.,
Plaintiff

v.

BOSTON COMMUNICATIONS GROUP, INC., CINGULAR WIRELESS LLC, AT & T WIRELESS PCS, CMT PARTNERS and WESTERN WIRELESS CORPORATION
Defendants.

CIVIL ACTION NO.:
00-12234-EFH

* *

<u>N O T I C E</u>

May 16, 2005

HARRINGTON, S.D.J.

Court Exhibit No. 2 has been revised to conform with the oral instructions given to the jury subsequent to the rulings at side bar on Requests for Further Instructions made on May 13, 2005 as follows:

Page 12, paragraph three, line 5. After the word "concealed," add "[h]ere, the parties agree that the Cominex invention was not abandoned, suppressed or concealed; therefore, you need not consider this element during your deliberations."

Page 15, paragraph one, line 7. Strike the words "is prior are [sic]" after the word "claim" and insert in place thereof the word "anticipates."

Page 15, paragraph four, line 2. Strike the word "three" and insert in place thereof the word "four."

Page 20, paragraph two, line 4. After the word "verdict," add "[t]his relates to opinions on obviousness."

Page 20, paragraph two, line 7. After the word "verdict," add [t]his relates to the prepaid system he claimed to have implemented in a hotel."

Page 12 has been corrected to reflect the accurate oral instruction given to the jury as follows:

Page 12, paragraph three, lines 5, 6 and 7. After the word "concealed" on line 5, add "[h]ere, the parties agree that the Cominex invention was not abandoned, suppressed or concealed; therefore, you need not consider this element during your deliberations as to the Cominex invention."

/s/ Edward F. Harrington
EDWARD F. HARRINGTON
United States Senior District Judge

EXHIBIT 2

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

FREEDOM WIRELESS, INC., Plaintiff, v. BOSTON COMMUNICATIONS GROUP, INC. et al., Defendants. And Related Counterclaims.	Civil Action No. 00-CV-12234-EFH

PLAINTIFF FREEDOM WIRELESS, INC.'S OPPOSITION TO BOSTON COMMUNICATION GROUP, INC.'S MOTION FOR JUDGMENT AS A MATTER OF LAW OF NO WILLFUL INFRINGEMENT

Defendant Boston Communication Group, Inc. moves under the "stringent" standard of Rule 50(a) for judgment as a matter of law that there was no willful infringement of Freedom's patents-in-suit. BCGI argues that Freedom has presented evidence only that it provided BCGI with notice of Freedom's patents, and that Freedom has presented no evidence that BCGI engaged in any culpable conduct. However, Freedom has presented sufficient evidence, beyond notice of its patents, for the jury to find willful infringement under the totality of the circumstances.

For these reasons, BCGI's motion should be denied in its entirety.

Wireless Service Agreement with Cingular Wireless, dated June 17, 2002)).[1] From this conduct, a jury could fairly infer that BCGI did not have a good faith belief that it was not infringing.

C. BCGI Obtained an Opinion from Counsel Merely for Use as a Shield Against Subsequent Claims of Willful Infringement

In fact, while BCGI's motion would have the Court treat Mr. Snowden's mere reference to an opinion letter as a defense to willfulness, Mr. Snowden admitted that BCGI did not obtain an opinion letter until April 1999—almost one year after BCGI received notice of Freedom's patents. (Trial Tr. (3/9/2005) 121:18-141:25). More tellingly, Mr. Snowden, BCGI's CEO, admitted that he did not even bother to read—let alone rely on—the opinion letters. (Id.) From this conduct, a fair inference is that BCGI obtained an opinion from counsel merely for use as a shield against subsequent claims of willful infringement. See, e.g., Central Soya Co., Inc. v. Geo. A. Hormel & Co., 723 F.2d 1573, 1577 (Fed. Cir. 1983) ("Hormel's intentional disregard of its counsel's opinion negates any inference of good faith, placing Hormel in the same position as one who failed to secure the advice of counsel. To overcome the district court's holding of

[1] See also Trial Ex. No. 855 (C2C Wireless Pre-Paid Calling Service Agreement with AT&T Wireless Services, Inc., dated Dec. 22, 1999); Trial Ex. No. 1011 (C2C Wireless Pre-Paid Calling Service Agreement with CMT Partners d/b/a AT&T Wireless, dated Jan. 1, 2000); Trial Ex. No. 876 (Prepaid Connection Agreement with Smith Bagley, Inc. d/b/a Cellular One of Northeast Arizona, dated Mar. 1, 2000); Trial Ex. No. 890 (Prepaid Connection Agreement with Bluegrass Cellular, Inc., dated Apr. 24, 2000); Trial Ex. No. 894 (Prepaid Connection Service Agreement with Price Communications, dated May 15, 2000); Trial Ex. No. 948 (Prepaid Connection Service Agreement with Brazos Cellular, dated Aug. 1, 2000); Trial Ex. No. 968 (Prepaid Connection Service Agreement with Great Lakes Cellular, dated Sept. 14, 2000); Trial Ex. No. 978 (Prepaid Connection Service Agreement with Thumb Cellular L.P., dated Oct. 27, 2000); Trial Ex. No. 989 (C2C Wireless Pre-Paid Calling Service Agreement with Cincinnati Bell Wireless, LLC, dated Nov. 27, 2000); Trial Ex. No. 1007 ((Prepaid Connection Service Agreement with Marseilles Cellular, Inc. d/b/a Illinois Valley Cellular, dated Jan. 2, 2001); Trial Ex No. 1006 (Prepaid Connection Service Agreement with PC Management, Inc., dated Jan. 30, 2001); Trial Ex. No. 1020 (Prepaid Connection Service Agreement with Wireless II, LLC d/b/a Nebraska Wireless Telephone Co., dated Apr. 10, 2001); Trial Ex. No. 1030 (Prepaid Connection Service Agreement with UBET, dated May 15, 2001).

willful infringement, Hormel had not only to show an opinion from competent counsel but also that it had exercised reasonable and good faith adherence to the analysis and advice therein.") (citations omitted); In re Hayes Microcomputer Prods., Inc. Patent Litig., 982 F.2d 1527, 1543-44 (Fed. Cir. 1992) ("The evidence shows that the advice of counsel was more of a protective device than a genuine effort to determine before infringing whether the patent was invalid. . . . Although [the defendant] received advice of counsel on the invalidity of the '302 patent, advice of counsel alone cannot be used as a shield irrespective of the nature and timing of that advice in the context of the surrounding circumstances") (citation omitted). Of course, absent evidence of "reliance," there is no basis for BCGI's claim of reliance on advice of counsel as a matter of law. See, e.g., Central Soya, 723 F.2d at 1577.

D. While Continuing To Infringe, BCGI Did Not Hold a Good Faith Belief that Its Systems Did Not Infringe or that Freedom's Patents Were Invalid or Unenforceable

Freedom has also presented evidence for the jury to find that while continuing to infringe Freedom's patents, BCGI did not even believe its counsel's opinion that BCGI was not infringing Freedom's patents. Mr. Snowden admitted that after it was sued by Freedom, BCGI hired a firm called "BountyQuest" to offer $60,000 in bounties to any persons who could come forward with "prior art" that might invalidate Freedom's patents. (Trial Tr. (3/10/2005) 26:4-29:21). From this conduct, the jury could fairly infer that BCGI did not have a good faith belief that its systems were non-infringing.

In addition, Mr. Snowden admitted that, before this action was filed, BCGI stated in its SEC filings that BCGI started to offer prepaid service in 1996. (Trial Tr. (3/10/2005) 4:20-7:1; Trial Ex. Nos. 4433, 4631, 4820). However, after this action was filed and BCGI received the original complaint based on the '067 patent, BCGI instead stated in its SEC filings that BCGI

started to offer prepaid service in mid-1994 (i.e., before the December 23, 1994 filing date of the application for the '067 patent). From such conduct, the jury could fairly infer that BCGI changed the dates as an attempt to hide its infringement of Freedom's valid and enforceable patents.

E. The Jury May Conclude That Infringement Was Clear

Although BCGI does not address the issue of infringement in its motion, Freedom has presented evidence that infringement was clear and did not involve close questions. This evidence includes testimony from Freedom's infringement expert Dr. Levine; testimony from defendants' representatives William Wessman, Edward Snowden, and Kenneth Sonberg (BCGI), Andrea Kullman (AT&T Wireless Services, Inc.), Heather Slee (Western Wireless), Judy Espejo (Cingular Wireless), and Larry Catipon (CMT Partners); and numerous documents from defendants' files regarding the components and functions of defendants' systems. This is another factor for the jury to consider in determining willful infringement. See, e.g., Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH, 383 F.3d at 1346.

F. The Jury May Conclude that BCGI Copied Freedom's System

Furthermore, Freedom presented evidence for the jury to find that BCGI copied Freedom's system. Lawrence Rybar—an engineer at Bell Atlantic Mobile, Inc. ("BAM"), a cellular carrier—testified (via deposition) that after meeting with representatives of Cellexis, visiting their operations, and inspecting their system in early 1995, Mr. Rybar would speak to or meet with BCGI about the same type of prepaid system—in some instances the following day. (See, e.g., Lawrence Rybar Dep. Tr. (9/26/2002) 48:7-48:17, 82:11-82:21, 115:3-115:11, 253:23-255:12, 255:15-257:8, 257:11-257:14, 258:1-261:1, 264:2-265:13, 266:20-268:2, 273:3-275:3, 277:15-277:16, 279:8-280:11, 298:17-300:9, 320:13-321:9 (played at trial on Mar. 7, 2005).) Mr. Rybar met with BCGI after acknowledging that no one had a system like Cellexis'; that Bell Atlantic Mobile should explore the "boundaries" of its confidentiality agreement with Cellexis; and that it should "scour" the marketplace for others. BCGI then started to offer prepaid services in 1996—starting with BAM, and working with Mr. Rybar and others to create the first implementation of the BCGI system. (Trial Tr. (3/10/2005) 4:20-7:1; Trial Ex. Nos. 4433, 4631, 4820). As discussed above, the jury may conclude that BCGI's prepaid system clearly infringes Freedom's system. From this evidence, the jury may also fairly infer that BCGI copied Freedom's system with the assistance of Mr. Rybar.

* * *

Accordingly, the principle case relied on by BCGI is inapposite. In Norian Corp. v. Stryker Corp., the plaintiff had presented evidence only that the defendant had infringed and had knowledge of the plaintiff's patents. 363 F.3d 1321, 1332 (Fed. Cir. 2004). The court expressed its concern that willful infringement should not be established by the mere fact of infringement. Id. That concern is not implicated here. As discussed above, Freedom has presented substantial

Conclusion

Freedom respectfully requests that the Court deny BCGI's motion in its entirety.

DATED: April 18, 2005

Respectfully submitted,

FREEDOM WIRELESS, INC.
By their attorneys

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EXHIBIT 3

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

FREEDOM WIRELESS, INC., Plaintiff, v. BOSTON COMMUNICATIONS GROUP, INC. et al., Defendants.	Civil Action No. 00-CV-12234-EFH
And Related Counterclaims.	

PLAINTIFF FREEDOM WIRELESS, INC.'S REPLY IN SUPPORT OF ITS MOTION FOR ATTORNEYS FEES AND ENHANCED DAMAGES

Preliminary Statement

In their opposition, defendants justify their overly aggressive litigation tactics not by their good faith belief in their defenses, but by the amount of money at stake. Defendants' desire to win, however, is not an excuse under the patent laws to litigate instead of license. Defendants concede they zealously sought out a defense by posting a bounty for potentially invalidating art, claiming there were four other unnamed inventors--all of which were abandoned at trial, hiring ten expert witnesses for hundreds of thousands of dollars each, asserting over three hundred documents as supposedly invalidating prior art, and taking over a hundred days of deposition. Defendants do not, and cannot, claim that they were merely gathering back-up for the good faith defense they always had. Under the patent laws, defendants must bear the entire cost of their fruitless search for a defense.

("Our cases uniformly indicate that the willfulness of the infringement by the accused infringer may be a sufficient basis in a particular case for finding the case 'exceptional' for purposes of awarding fees to the prevailing patent owner.").

BCGI claims that the evidence amounted to no more than a few questions of Mr. Snowden.[17] But evidence of willfulness also included BCGI's failure to respond to Freedom's notice letter,[18] BCGI's offer of $60,000 in bounties to any persons who could come forward with prior art that might invalidate Freedom's patents,[19] the post-lawsuit decision to change of the date BCGI claimed in its SEC filings to have begun offering prepaid service to a date earlier than Freedom's patent application,[20] the testimony of defendants' representatives William Wessman, Edward Snowden, and Kenneth Sonberg (BCGI), and numerous documents from defendants' files establishing that infringement was clear and that defendants' distinctions were not credible, the fact that BCGI was only successful at developing its prepaid system after working with Bell Atlantic Mobile engineer who had just inspected Freedom's patented technology and stated that he would "scour the marketplace" for another provider,[21] and the witnesses' unbelievable testimony that they had never heard of Cellexis prior to the lawsuit.[22]

Defendants' opposition also attaches five opinions of counsel and asserts that "this evidence . . . strongly supported the conclusion that there was no willful

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[17] Mot. at 10.

[18] Trial Testimony of Larry Day, President of Freedom Wireless, March 28, 2005, at 17:6-20:15.

[19] Trial Testimony of E. Y. Snowden, President of BCGI, March 10, 2005, at 26:4-29:21.

[20] Trial Testimony of E. Y. Snowden, President of BCGI, March 10, 2005, at 4:20-7:1; Trial Ex. Nos. 4433, 4631, 4820.

[21] Lawrence Rybar Dep. Tr., September 26, 2002, at 48:7-48:17, 82:11-82:21, 115:3-115:11, 279:8-280:11, 298:17-300:9, 320:13-321:9 (played at trial on Mar. 7, 2005); Trial Testimony of E. Y. Snowden, BCGI's President, March 10, 2005, 4:20-7:1; Trial Ex. Nos. 4433, 4631, 4820.

[22] See, e.g., Trial Testimony of Kimberly Obremski, April 7, 2005, at 14:11-29:6.

infringement."[23] Defendants did not attempt to introduce any of these opinions at trial. Had they done so, Freedom would have presented evidence that defendants did not reasonably rely on them as a good faith basis to continue their infringement, including:

- BCGI's first advice of counsel, and the only one it received before the litigation, was written by BCGI's litigation counsel, Foley Hoag. Moreover, it's author and signatory was just an associate at the time.[24] It was based on such dubious grounds as "Although the cellular switch may perform operations to work with the BCGI Prepaid System, it is not the BCGI Prepaid System itself that performs operations at the cellular switch."[25]

- BCGI did not obtain even that opinion until April 15, 1999, nine months after receiving notice of infringement from Freedom, eight months after receiving a request from a carrier customer for an analysis "preferably in the form of an opinion from your outside counsel,"[26] seven months after another carrier customer requested "some form of assurance that we are not infringing on anyone's patents,"[27] six months after the associate giving the opinion told BCGI it would need a letter to comply with due diligence,[28] and five months after BCGI threatened to fire the author, Foley, Hoag if it did not promptly deliver the requested opinion of counsel.[29]

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[23] Mot. at 12.

[24] Deposition of Edward Kelly, April 24, 2002, at 41:14-16 (Taggart Aff., Exh. E).

[25] Foley, Hoag & Eliot opinion, dated April 15, 1999, at 20 (Henry Aff., Exh. C).

[26] Letter from Greg Caligari to Boston Communications Group, July 13, 1998, at 1, Identification Trial Exhibit 707-1 (not introduced in evidence) (Taggart Aff., Exh. F).

[27] Fax from Alan Bouffard to Ed Kelly, August 12, 1998, attaching August 11, 1998 Memo from Bob Matthews (BCGI), forwarding BAM's August 5, 1998 letter, Identification Trial Exhibit 719 (not introduced in evidence) (Taggart Aff., Exh. G).

[28] Letter from Edward Kelly to Alan Bouffard, August 6, 1998, Identification Trial Exhibit 717 (not introduced in evidence) (Taggart Aff., Exh. H) ("to ensure that we use the proper diligence in addressing this matter, I have docketed a date of 15 September 1998 for completing this analysis. My understanding of U.S. patent laws is that this timeframe evidences the proper diligence in addressing such a matter.").

[29] Fax from Alan Bouffard to Ed Kelly, November 9, 1998, Identification Trial Exhibit 743 (not introduced in evidence) (Taggart Aff., Exh. I) ("Please provide a written

> The other four letters were done by another firm during the litigation and were dated more than seventeen months after the lawsuit was filed. These litigation opinions included such dubious bases as that the system does not "cause the call to be connected" because it directs the switch to disconnect the call.[30] The author gave this opinion despite the fact that defendants had already filed a sworn statement explaining that "If the maximum call duration is reached before the Node Site senses an 'on-hook' condition from either the subscriber's cellular telephone or the destination telephone number, the Node Site will <u>cause the call to be terminated</u>. . ."[31]

There was thus more than sufficient evidence that BCGI willfully infringed Freedom's patents and had no good faith basis to force Freedom to endure five years of litigation. <u>See</u> <u>Jurgens v. CBK, Ltd.</u>, 80 F.3d 1566, 1572 -1573 (Fed. Cir. 1996) ("If infringers could rely on any opinion to defeat willful infringement, no matter how incompetent, insulation from increased damages would be complete."). It also participated in defendants' overall strategy of boundless litigation, including paying hundreds of thousands of dollars for a purported license from the former employer of one of Freedom's inventors.[32] Moreover, BCGI, along with Cingular, continues to infringe Freedom's patents and shows no signs of voluntarily stopping or paying a royalty.

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response on Freedom Wireless. If I do not receive a response by this Friday (11/13), I will assume that you have abandoned the matter and hire other counsel. BCGI cannot afford to lose further credibility on this matter.").

[30] Letter from Stanley M. Schurgin to Alan J. Bouffard, August 24, 2001, at page 42 (Henry Aff., Exh. D) ("[T]he BCGI system does not cause a call to be connected to a destination. Rather this function is performed by a respective MSC in a manner well-known to practitioners in the art.").

[31] Corrected Declaration of William D. Wessman in Support of Defendant Boston Communications Group, Inc.'s Motion to Transfer Venue, June 14, 2000, Trial Exhibit 904.

[32] License & Covenant Not To Sue between Orbital Sciences Corporation and Boston Communications Group Inc., May 2002, Identification Trial Exhibit 1163 (not admitted in evidence) (Taggart Aff., Exh. J).

CERTIFICATE OF SERVICE

I, Erica P. Taggart, hereby certify that on October 14, 2005, I caused a true copy of the foregoing Plaintiff Freedom Wireless, Inc.'s Reply in Support of Its Motion for Attorneys Fees and Enhanced Damages to be served by overnight courier, by hand and facsimile to counsel of record.

Dated: October 14, 2005

Erica P. Taggart

LIBA/1638818.1

EXHIBIT 4

APPEAL, STAY

United States District Court
District of Massachusetts (Boston)
CIVIL DOCKET FOR CASE #: 1:00-cv-12234-EFH

Freedom Wireless Inc v. Boston Communication, et al
Assigned to: Judge Edward F. Harrington
Demand: $0
Related Cases: 1:05-cv-11061-EFH
1:05-cv-11062-EFH
Case in other court: N.D. of CA (Oakland), 00-cv-1129
Cause: 28:1338 Patent Infringement

Date Filed: 10/30/2000
Jury Demand: Defendant
Nature of Suit: 830 Patent
Jurisdiction: Federal Question

Plaintiff

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10/20/2003	896	CERTIFICATE OF CONSULTATION re 894 MOTION to Modify scheduling order by John Nilsson on behalf of Boston Communications Group, Inc.. (Holahan, Sandra) (Entered: 10/21/2003)
10/24/2003	897	MOTION to Strike portions of the 9/13/2003 reply report of Dr. Richard Levine and 9/17/2003 claim charts by Boston Communications Group, Inc..(Holahan, Sandra) (Entered: 10/28/2003)
10/24/2003	898	MEMORANDUM in Support re 897 MOTION to Strike filed by Boston Communications Group, Inc.. (Holahan, Sandra) (Entered: 10/28/2003)
10/24/2003	899	MOTION to Seal by Boston Communications Group, Inc..(Holahan, Sandra) (Entered: 10/28/2003)
10/24/2003	900	****** SEALED ****** APPENDIX re 897 MOTION to Strike by Boston Communications Group, Inc.. (Attachments: # 1 Exhibit A-E NOT SCANNED)(Holahan, Sandra) (Entered: 10/28/2003)
10/29/2003	901	RENEWED MOTION for PARTIAL Summary Judgment re Infringement of selected claims of the '823 Patent by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	902	STATEMENT of UNDISPUTED Material and claim chart facts in support of 901 MOTION for Summary Judgment. c/s (Attachments: # 1 pages 36 - 73)(Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	903	ASSENTED MOTION for Leave to File Memorandum of Law in excess of page limit by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	904	ASSENTED MOTION to Seal by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	905	****** SEALED ****** MEMORANDUM in Support re 901 MOTION for Summary Judgment filed by Freedom Wireless Inc. (Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	906	****** SEALED ****** AFFIDAVIT of Marshall M Searcy III, Esq. re 901 MOTION for Summary Judgment by Freedom Wireless Inc. (VOLUME I, EXHIBITS 1-10) (Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	907	****** SEALED ****** AFFIDAVIT of Marshall M. Searcy III, Esq. re 901 MOTION for Summary Judgment by Freedom Wireless Inc. (VOLUME II, EXHIBITS 11-23) (Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	908	****** SEALED ****** AFFIDAVIT of Marshall M. Searcy III, Esq. re 901 MOTION for Summary Judgment by Freedom Wireless Inc. (VOLUME III, EXHIBITS 24-54) (Holahan, Sandra) (Entered: 10/31/2003)
10/29/2003	909	****** SEALED ****** AFFIDAVIT of Marshall M. Searcy III, Esq. re 901 MOTION for Summary Judgment by Freedom Wireless Inc. (VOLUME IV, EXHIBITS 55-64) (Holahan, Sandra) (Entered:

01/23/2004	980	****** SEALED ****** MOTION for Partial Summary Judgment that the patents are enforceable by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	981	ASSENTED MOTION to Seal by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	982	ASSENTED MOTION for Leave to File memorandum in excess of 20 pages by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	983	****** SEALED ****** STATEMENT of undisputed material facts re 980 MOTION for Partial Summary Judgment that the patents are enforceable. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	984	****** SEALED ****** MEMORANDUM in Support re 980 MOTION for Partial Summary Judgment that the patents are enforceable filed by Freedom Wireless Inc. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	985	****** SEALED ****** AFFIDAVIT of Marc Morriss in Support re 980 MOTION for Partial Summary Judgment that the patents are enforceable. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	986	MOTION for Partial Summary Judgment regarding the on-sale bar by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	987	ASSENTED MOTION to Seal by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	988	ASSENTED MOTION for Leave to File memorandum in excess of 20 pages by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	989	****** SEALED ****** STATEMENT of undisputed material facts re 986 MOTION for Partial Summary Judgment regarding the on-sale bar. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	990	****** SEALED ****** MEMORANDUM in Support re 986 MOTION for Partial Summary Judgment regarding the on-sale bar filed by Freedom Wireless Inc. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	991	****** SEALED ****** AFFIDAVIT OF Erica P. Taggart in Support re 986 MOTION for Partial Summary Judgment regarding the on-sale bar. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	992	MOTION for Partial Summary Judgment of INVALIDITY by Boston Communications Group, Inc..(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	993	MEMORANDUM in Support re 992 MOTION for Partial Summary Judgment of INVALIDITY filed by Boston Communications Group, Inc.. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	994	STATEMENT of undisputed material facts re 992 MOTION for Partial Summary Judgment of INVALIDITY. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	995	****** SEALED ****** AFFIDAVIT of Peter A. Casciato, Esq. in

		Support re 992 MOTION for Partial Summary Judgment of INVALIDITY. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	996	****** SEALED ****** APPENDIX of EXHIBITS re 992 MOTION for Partial Summary Judgment of INVALIDITY by Boston Communications Group, Inc.. (VOLUME I)(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	997	****** SEALED ****** APPENDIX of EXHIBITS re 992 MOTION for Partial Summary Judgment of INVALIDITY by Boston Communications Group, Inc.. (Holahan, Sandra) (VOLUME II) (Entered: 01/28/2004)
01/23/2004	998	****** SEALED ****** APPENDIX of EXHIBITS re 992 MOTION for Partial Summary Judgment of INVALIDITY by Boston Communications Group, Inc.. (VOLUME III)(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	999	MOTION for Partial Summary Judgment of NONINFRINGEMENT by Boston Communications Group, Inc..(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1000	****** SEALED ****** MEMORANDUM in Support re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT filed by Boston Communications Group, Inc.. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1001	****** SEALED ****** STATEMENT of undisputed material facts re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT. (Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1002	****** SEALED ****** APPENDIX of EXHIBITS re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT by Boston Communications Group, Inc.. (VOLUME I)(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1003	****** SEALED ****** APPENDIX of EXHIBITS re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT by Boston Communications Group, Inc.. (VOLUME II)(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1004	****** SEALED ****** APPENDIX of EXHIBITS re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT by Boston Communications Group, Inc.. (VOLUME III)(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1005	****** SEALED ****** APPENDIX of EXHIBITS re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT by Boston Communications Group, Inc.. (VOLUME IV)(Holahan, Sandra) (Entered: 01/28/2004)
01/23/2004	1006	****** SEALED ****** APPENDIX of EXHIBITS re 999 MOTION for Partial Summary Judgment of NONINFRINGEMENT by Boston Communications Group, Inc.. (VOLUME V)(Holahan, Sandra) (Entered:

07/02/2004	1183	MOTION for Leave to Appear Pro Hac Vice by Charles K. Verhoeven by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 07/06/2004)
07/06/2004		Filing fee: $ 50.00, receipt number 57043 regarding motion to appear phv (Holahan, Sandra) (Entered: 07/07/2004)
07/07/2004	1184	NOTICE of lodging supplemental affidavit of Diane C. Hutnyan in support of plaintiff's reply brief by Freedom Wireless Inc re 901 MOTION for Summary Judgment (Attachments: # 1 Exhibit A - 15 (NOT SCANNED))(Holahan, Sandra) (Entered: 07/14/2004)
07/08/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered granting 1183 Motion for Leave to Appear Pro Hac Vice Added Charles K. Verhoeven for Freedom Wireless Inc. MOTION ALLOWED. cc/cl (Holahan, Sandra) (Entered: 07/12/2004)
07/08/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered granting 1179 Motion for Leave to File response. MOTION ALLOWED. cc/cl (Holahan, Sandra) (Entered: 07/12/2004)
07/08/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered granting 1181 Motion for Leave to File reply brief. MOTION ALLOWED. cc/cl (Holahan, Sandra) (Entered: 07/12/2004)
07/12/2004	1185	MOTION for Leave to File supplemental memorandum in support of motion for S/J on claims 16 and 35 by Freedom Wireless Inc.(Holahan, Sandra) (Entered: 07/14/2004)
07/12/2004	1186	SUPPLEMENTAL MEMORANDUM in Support re 901 MOTION for Summary Judgment filed by Freedom Wireless Inc. and in OPPOSITION to Boston Communications motion for partial S/J of noninfringement as to claims 10-14 and 16-18 of the '067 patent and claims 2,3,5,9-12,15-20,29-31,34,36-39,42,53,57 and 59 of the '823 patent(Holahan, Sandra) (Entered: 07/14/2004)
07/13/2004	1187	Letter(non-motion) from Scott G. Lindvall, Esq.. (Attachments: # 1 Exhibit (NOT SCANNED))(Holahan, Sandra) (Entered: 07/14/2004)
07/14/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered granting 1185 Motion for Leave to File memorandum. MOTION ALLOWED. cc/cl (Holahan, Sandra) (Entered: 07/14/2004)
07/15/2004	1188	OPPOSITION and RESPONSE to plaintiff's supplemental memorandum in support of 901 MOTION for Summary Judgment and in opposition to Boston Communications motion for partial S/J of noninfringement as to claims 10-14 and 16-18 of the '067 patent and claims 2,3,5,9-12,15-20,29-31,34,36-39,42,53,57, and 59 of the '823 patent filed by Boston Communications Group, Inc.. (Holahan, Sandra) (Entered: 07/19/2004)
07/16/2004	1189	Letter(non-motion) from Paul F. Ware, Esq.. (Holahan, Sandra) (Entered: 07/20/2004)
08/05/2004	1190	Judge Edward F. Harrington : ELECTRONIC ORDER entered denying 901 Motion for Summary Judgment, denying 967 Motion for Summary

		Judgment, denying 970 Motion for Summary Judgment, denying 974 Motion for Partial Summary Judgment, denying 980 Motion for Partial Summary Judgment, denying 986 Motion for Partial Summary Judgment, denying 992 Motion for Partial Summary Judgment, denying 999 Motion for Partial Summary Judgment (Holahan, Sandra) (Entered: 08/10/2004)
08/12/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered granting 1008 Motion for Joinder. MOTION ALLOWED. cc/cl (Holahan, Sandra) (Entered: 08/12/2004)
08/17/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered denying 1160 Motion to Dismiss. MOTION DENIED. cc/cl (Holahan, Sandra) (Entered: 08/19/2004)
08/30/2004		Motions terminated: [183] Motion to Compel filed by Freedom Wireless Inc, [185] Motion to Compel filed by Freedom Wireless Inc, [218] Motion to Compel filed by Cellco Partnership, [258] Motion to Compel filed by Freedom Wireless Inc. (Holahan, Sandra) (Entered: 08/30/2004)
08/30/2004		Motions terminated: [119] Motion to Dismiss filed by Bellsouth Cellular, Corp., Bellsouth Mobility, Inc., Southwestern Bell Mobile Systems, Inc., [95] Motion to Dismiss filed by Freedom Wireless Inc, Alltel Communications Products, Inc.. (Holahan, Sandra) (Entered: 08/30/2004)
08/30/2004	1191	MOTION for status conference and trial date by Freedom Wireless Inc. (Holahan, Sandra) (Entered: 09/07/2004)
08/31/2004	1192	RESPONSE to Motion re 1191 MOTION for status conference and trial date filed by AT & T Wireless PCS, Airtouch Communications, Inc., Boston Communications Group, Inc., CMT Partners, Western Wireless Corporation. (Holahan, Sandra) (Entered: 09/07/2004)
09/09/2004		Judge Edward F. Harrington : ELECTRONIC ORDER entered denying 1191 Motion for Hearing and trial date. MOTION DENIED. PRE-TRIAL CONFERENCE IS SET FOR 11/8/2004 AT 2:00 P.M. cc/cl (Holahan, Sandra) (Entered: 09/09/2004)
09/09/2004	1193	Judge Edward F. Harrington : PROCEDURAL ORDER re pretrial Final Pretrial Conference set for 11/8/2004 02:00 PM in Courtroom 13 before Edward F. Harrington. SO ORDERED. cc/cl(Holahan, Sandra) (Entered: 09/09/2004)
09/09/2004	1194	MOTION to Compel discovery relating to Freedom's decision to withhold prior art from the patent office by AT & T Wireless PCS, Airtouch Communications, Inc., Boston Communications Group, Inc., CMT Partners, Cingular Wireless LL, Western Wireless Corporation. (Holahan, Sandra) (Entered: 09/13/2004)
09/09/2004	1195	MEMORANDUM in Support re 1194 MOTION to Compel filed by AT & T Wireless PCS, Airtouch Communications, Inc., Boston Communications Group, Inc., CMT Partners, Cingular Wireless LL, Western Wireless Corporation. (Holahan, Sandra) (Entered: 09/13/2004)
09/09/2004	1196	APPENDIX OF EXHIBITS re 1194 MOTION to Compel filed by

EXHIBIT 5

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

IN RE: CHIPCOM CORPORATION) CIVIL ACTION NO.
SECURITIES LITIGATION) 95-11114-DPW

MEMORANDUM AND ORDER
April 29, 1996

I.

This is a consolidated putative class action alleging securities fraud violations by Chipcom Corporation ("Chipcom") and certain individual defendants.[1] Specifically, plaintiffs allege violations under § 10(b) (Count I) and § 20(a) (Count II) of the Securities Exchange Act of 1934. The action is brought on behalf of purchasers of Chipcom common stock during the period of February 8, 1995 through and including May 26, 1995

[1]The individual defendants are:
John Robert Held ("Held")
-President and Chief Executive Officer, member of Board of Directors
Robert Peter Badavas ("Badavas")
-Senior Vice President, Finance, and Chief Financial Officer
Bruce L. Cohen ("Cohen")
-Senior Vice President, Field Operations
Menachem E. Abraham ("Abraham")
-Senior Vice President, Product Development, and Chief Technical Officer
Jerald G. Fishman ("Fishman")
-member of Board of Directors

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("the class period").[2]

The plaintiffs contend that during the class period the defendants made materially false and misleading statements, and failed to disclose information regarding Chipcom's operations, competitive position and future business prospects. Especially at issue is defendants' alleged knowledge that the primary distribution channel, International Business Machine Corporation ("IBM"), was 1) oversupplied with Chipcom's products, 2) experiencing difficulties selling the products, and 3) reducing orders, thereby drastically affecting Chipcom's revenues. A

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[2]The named plaintiffs are:

Plaintiffs	Purchase Date	Shares	Share Price
Manuel & Barbara De Sousa	February 10, 1995	100	$46.50
Anthony Malozzi	March 3, 1995	5000	$35.625
	March 29, 1995	5000	$42.375
	March 29, 1995	5000	$42.50
	March 30, 1995	5000	$40.75
	March 30, 1995	5000	$39.625
Carol Benjamin	March 30, 1995	500	$38.25
Marc Linsky	April 5, 1995	150	$33.25
Sean Carney	April 13, 1995	500	$32.75
N. Giannantonio	April 13, 1995	500	$32.75
	May 23, 1995	500	$34
Constandine & Mary Machakos	April 20, 1995	300	$28.75
Daniel List	May 1, 1995	200	$32.25
Lucille Nappo	May 9, 1995	300	$35
Victor Mosso	May 15, 1995	20	$32.50

critical consideration in these claims is *when* Chipcom became aware of this situation and *what* duty it had to disclose what it knew.

Chipcom announced on April 19, 1995 that second quarter IBM revenue would be approximately $24 million (20% less than the first quarter). On May 26, 1995, Chipcom lowered the prediction to $15 million (50% less than the first quarter). That day, Chipcom's stock plummeted by $11 7/8 or 37%.[3] Plaintiffs allege that Chipcom had knowledge of the gravity of the situation before May 26, indeed before April 19, and had a duty to disclose its knowledge.

The original complaint in this action was filed on May 30, 1995, four days after the precipitous fall in stock price. A second consolidated complaint was filed on September 13, 1995. A third version, the "Consolidated First Amended Complaint" ("Complaint"), challenged by defendants' motion to dismiss, is now before me.

II.

Chipcom designed, manufactured and distributed computer networking fault-tolerant intelligent switching systems, including hubs and internetworking and network management products.[4] During the relevant period, Chipcom was the world's

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[3]Approximately 1,502,300 shares were traded, representing almost 10% of all outstanding shares.

[4]On December 29, 1995, Chipcom merged into 3Com Corporation, and ceased to exist. (Defs.' Reply to Pls.' Opp'n at 1, n.1.) At all relevant times, Chipcom's stock was traded on NASDAQ, and

third largest supplier of intelligent hubs, and approximately 70-80% of revenues were generated from the sales of intelligent hubs. (Compl. ¶ 47.) Switching hubs allow users "to build and manage networks with dissimilar hardware and software technologies within an entire building or campus or across remote locations of an enterprise." (Compl. ¶ 16(a).) "Fault tolerant" technology allows networks to run without interruption, if a connection or component should fail.[5] (Compl. ¶ 48.)

Chipcom marketed and sold its products primarily through third-party distribution channels, including value-added resellers, original equipment manufacturers and distributors (collectively "resellers"). Although Chipcom dealt with 245 resellers worldwide, the single most important reseller was IBM.

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was registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 78l. Approximately 16,910,109 shares of Chipcom stock were outstanding as of March 10, 1995. (Compl. ¶ 16(b).) Chipcom was incorporated in Delaware with its principal place of business in Southborough, Massachusetts.

[5]Chipcom's various hub products included:
1) the ONline System Product Family (introduced in 1990) [product 8250];
2) the ONcore Switching System (the ONline system designed for high end enterprise networks, introduced in the first quarter of 1994) [product 8260];
3) the InfiNET Switching Solutions (family of packet-switching products providing increased network capacity and speed, including the Galactica Network Switching Hub, introduced in 1994); and
4) the ONsemble StackSystem (Ethernet and Token Ring hubs, designed for remote sites or workgroups, incorporating technology from third-party vendors; introduced during the first quarter of 1995 but not available for distribution).

(Compl. ¶ 49.)

(Compl. ¶ 50.)

Chipcom's relationship with IBM began in September 1992 upon the signing of the "Alliance Agreements."[6] The Alliance Agreements established a mutually beneficial marketing and development affiliation: the companies would make available to each other certain products, and agreed to jointly develop hub technology. For example, IBM would gain access to Chipcom's hub and switching technology, and Chipcom would gain access to IBM's research on Token Ring technology and Asynchronous Transfer Mode ("ATM") technology.[7] (Compl. ¶¶ 51-52.)

The Alliance Agreements also provided for a comprehensive meeting and review process. First, the Agreements provided that each company would appoint an Alliance Executive, a Marketing Executive, a Financial Executive, and a Development Executive, all of whom (known as the "Alliance Executive Committee") would be jointly responsible for overseeing the Agreements. (Compl. ¶¶ 53-55.) Further, the Agreements required: 1) that the Alliance Executive Committee meet semi-annually, 2) that the President of Chipcom and the IBM General Manager for Networking Services Line of Business ("NSLOB") meet annually, and 3) that there would be

[6]The companies signed three integrated commercial agreements: the Master Agreement, the Remarketing Agreement and the Development Agreement (collectively known as the "Alliance Agreements"). (Compl. ¶ 51.)

[7]ATM is a cell switching technology designed to simultaneously transport data, voice and video at greater speeds than standard Ethernet or Token Ring. IBM was the sole supplier of ATM and Token Ring expertise to Chipcom in 1994. (Compl. ¶ 75.)

individual Marketing/Remarketing, Financial, and Development meetings each quarter, during which time important information such as volume outlooks, industry trends, project status, and relevant financial data would be shared. (Compl. ¶¶ 58-63.)

Specifically, the Remarketing Agreement required either party, after deciding to remarket the other party's product, to submit 1) an initial three-year forecast of volume requirements, 2) interval three-month forecasts for the coming twelve month period, and 3) firm purchase orders at least ninety days prior to a delivery date.[8] (Compl. ¶¶ 64-65.) Chipcom recognized the importance of the forecasts, stating in its March 30, 1995 10K report that the "volume of products to be sold by the Company to IBM [was] based on forecasts supplied by IBM and not on specific purchase requirements." (Compl. ¶ 69.) In addition to the formal requirements, plaintiffs allege that informally

> IBM and Chipcom constantly communicated at various organizational levels . . . in order to remain current as to the state of all aspects of their relationship, including inventory needs, product and spare parts levels, forecasts of purchasing requirements, development projects, engineering changes and the sales and purchases of Remarketing products.

(Compl. ¶ 62.)

Chipcom began selling products to IBM under the Alliance Agreements in the fourth quarter of 1992. Over the next two years, sales to IBM increased dramatically:

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[8]Modifications or cancellations of purchase orders were strictly controlled, triggering penalties under an agreed upon schedule. (Compl. ¶ 67.)

IBM Contribution to Chipcom Revenues
(in millions)

	1993	1Q94	2Q94	3Q94	4Q94	1994	1Q95
Total Revenue		51.9	61.3	71.7	82.9	267.8	86.2
IBM $	34.0	15.5	25.7	29.6	31.6	102.4	30.6
IBM %	21.2	29.9	41.9	41.3	38.1	38.2	35.5

(Compl. ¶¶ 81, 85) (percentages supplied.)

Accordingly, Chipcom's total revenues increased. A February 7, 1995 press release announced that the fourth quarter of 1994 and fiscal year 1994 were "the most successful periods in the Company's 11-year history" (Compl. ¶ 84; Appendix, Ex. 3), that fourth quarter 1994 revenues were up 72% from the fourth quarter of 1993, and that earnings for the quarter were up 77%. (Compl. ¶ 84.)

Chipcom's total revenues continued to increase from the fourth quarter of 1994 through the first quarter of 1995. In fact, an April 19, 1995 press release statement reported record first quarter revenues for 1995 of $86.21 million, a 66% increase over the first quarter of 1994. In addition, the company announced quarterly net income of $8 million--or $0.45 per share --a 300% increase over the first quarter of 1994. (Compl. ¶ 111.) IBM's contribution to total revenues dipped only slightly from $31.6 million to $30.6 million. (Compl. ¶ 85.)

Also on April 19, 1995, Chipcom made its first *public projection* for the second quarter, announcing that IBM revenues would be in the $24 million range (20% down from first quarter). Since February, the *internal* projections for second quarter IBM revenues had dropped from $30 million to approximately $22 million throughout March, with the exception of a $32 million

March 17 estimate. Nevertheless, since early February, the *yearly* IBM revenue projections remained constant, and the yearly *total* revenue projections actually increased during early March. (Appendix, Exs. 1, 2, 15, 16, 20.)

Ultimately, however, sales to IBM suffered a more severe setback during the second quarter of 1995. On May 26, 1995, Chipcom lowered the prediction to $15 million (50% down from first quarter). The plaintiffs allege that the defendants knew of the gravity of the developing "IBM problem," yet misled investors by failing to disclose the information--while continuing to make optimistic statements--thereby artificially inflating stock prices. In support, plaintiffs' Complaint identifies numerous statements alleged to have been made by Chipcom, the individual defendants and other third-parties. The statements are derived from various documents--press releases, internal memos, transcripts of conference calls with analysts, and transcripts of interviews.[9] Finally, plaintiffs set forth

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[9]I note that defendants too readily reduce the 79-page, 164-paragraph Complaint to "seven statements." (Defs.' Mem. in Supp. of Mot. to Dismiss at 3.) In contrast, the meandering and loosely organized Complaint repetitively weaves fragmented portions of over twenty documents throughout the 164 paragraphs, creating the illusion of greater quantity.

At an April 10, 1996 hearing on the motion to dismiss, the plaintiffs identified as actionable eight dated communications, captured in identifiable documents, which I find contain sixteen discrete statements. I find the proper approach for review is to demarcate each "discrete unit" of language capable of legal analysis. "Statements" for purposes of securities analysis does not necessarily refer to "documents" or "sentences" but to identifiable language capable of legal analysis. <u>See</u>, <u>e.g.</u>, <u>Shapiro v. UJB Financial Corp.</u>, 964 F.2d 272, 284 (3rd Cir.), <u>cert. denied</u>, 506 U.S. 934 (1992) ("In light of the confusion that pervades plaintiffs' allegations, we conclude that the entire complaint must be reorganized. . . . on remand plaintiffs

additional facts consisting of internal projections, and insider trading figures.

A. **Alleged Actionable Statements**
(emphasis added)

[<u>February 7, 1995</u>: 1994 yearly and quarterly results announced.]

1. **<u>February 8, 1995 Press Release</u>:**

a. [Chipcom and IBM] today announced a <u>significant, multiyear expansion</u> to the existing strategic, worldwide development and marketing alliance between the two firms, originally signed in September, 1992, to now include several new product and technology areas.
(Appendix, Ex. 4; Compl. ¶ 150(a)(i), 89.)

b. **<u>Held Statement</u>**
This extension <u>strengthens</u> our <u>already strong alliance</u> with IBM. . . . The IBM-Chipcom relationship <u>has been mutually beneficial from day one</u>, and we are obviously extremely delighted that IBM has endorsed our Ethernet and Token Ring stackable hubs and Ethernet switching technologies as important additions to their product arsenal.
(Appendix, Ex. 4; Compl. ¶ 91.)

2. **<u>March 6, 1995 Abraham Statement in Business Wire</u>:**
[Chipcom, IBM and Ericsson announcing their intention to enter into a strategic relationship to introduce multimedia networking solutions to business communication market.]

a. This three-company relationship <u>builds</u> on Chipcom's <u>already strong</u> and <u>recently expanded strategic alliance</u> with IBM and is the next step in deepening and widening our existing reseller relationship with Ericsson. . . .
(Appendix, Ex. 17; Compl. ¶¶ 99, 150(c)(i).)

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should rearrange the existing allegations into discrete units that are, standing alone, each capable of evaluation under the legal principles we have set forth").

In addition, at the April 10, 1996 hearing I ordered that the original documents which plaintiffs contend captured the actionable statements be promptly submitted to the court as an appendix to the Complaint. The reasons for requiring the Appendix were 1) to allow assessment of the Complaint in light of Rule 9(b)'s particularity requirement, and 2) to provide context, completeness, and comparison against plaintiffs' truncation and paraphrasing in the Complaint.

I may refer to the full texts of plaintiffs' documents--now an Appendix to the Complaint itself--under the authority of <u>Watterson v. Page</u>, 987 F.2d 1, 3 (1st Cir. 1993) and <u>San Leandro Emergency Medical Group v. Philip Morris Companies</u>, 75 F.3d 801, 808-809 (2d Cir. 1996).

b. The broad, complementary technology base of Ericsson, IBM and Chipcom will serve as an <u>excellent foundation for the exciting product development activities ahead of us</u>.
(Appendix, Ex. 17; Compl. ¶¶ 99, 150(c)(i).)

3. **<u>March 30, 1995 Held Letter in Annual Report</u>:**

[addressing several reasons for the success during 1994 . . .] Chipcom's <u>third-party relationships were important</u> to the Company's success in 1994, especially our strategic marketing and development alliance with IBM which <u>remains strong and mutually beneficial</u>. IBM's ongoing[10] investments in [ATM] and Token Ring technologies, combined with Chipcom's internal development efforts, <u>will allow us to continue our expansion</u> in these important areas.
(Appendix, Ex. 21; Compl. ¶¶ 75, 83.)[11]

4. **<u>April 5, 1995 Business Wire Report</u>:**
[preliminary first quarter 1995 revenues announced]

[D]ue to recent heavy trading volumes in its stock [the company decided to announce] preliminary financial results for the first quarter. . . . <u>The company announced that, on the basis of information available to date, revenue for the quarter is expected to be approximately $86 million</u>, and earnings per share are expected to range between $0.44-$0.46.
(Appendix, Ex. 22; Compl. ¶ 104.)

5. **<u>April 6, 1995 Radio Interview (Held Statements)</u>:**

a. [The] Company <u>expects to have another very good year</u>. We are forecasting <u>for the year</u> . . . analysts are forecasting and we are supporting forecast[s] which would place the Company at the $370 million revenue range and the $2 dollar to maybe a little above range for earnings <u>for the year as a whole</u>. <u>Those</u>

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[10]Plaintiffs use the adjective "continuing" (<u>see</u> Compl. ¶ 39), while "ongoing" is used in the original document. (Appendix, Ex. 21.)

[11]An almost identical statement by Held appeared in the February 7, 1995 press release announcing 1994 yearly and fourth quarter results:

> Chipcom's third-party relationships were also important to the company's success [ ] especially our strategic marketing and development alliance with IBM which <u>remains strong and mutually beneficial</u>. IBM's ongoing investments in ATM and Token Ring technologies will allow us to <u>continue expanding</u> our product lines in these important areas.
> (Appendix, Ex. 3, Compl. ¶ 84.)

forecasts, are very reasonable. . . .

b. [The] IBM relationship continues to be a very important relationship for Chipcom, in multiple senses. It is both a technology relationship as well as a sales channel.

c. [A]s a sales channel it has been very, very successful for us. We are very happy with the way it's performing overall . . . year to year growth has been very strong. . . .

d. [Chipcom and IBM's transition from ONline to ONcore is] going very well. . . . [T]he exact balance between these two products is always a little hard to forecast. IBM is [] moving through the transition as are we . . . in any transition, you have to be very careful about how you manage the stock [IBM's inventory]. But IBM's actual performance in Q1 for both products [ONline and ONcore] was substantially higher than it was, for example, a year ago. (Appendix, Ex. 24; Compl. ¶¶ 106-108; 35.)[12]

6. April 11, 1995 Robertson Stephens & Co. Statement: (distributed April 19, 1995)

Chipcom's management preannounced guidance for the quarter that was completely consistent with previous guidance and our expectations for the quarter. As a result, the final results should come as no surprise to anyone. The real issue remains forward guidance. There have been numerous concerns expressed among investors that Chipcom's business with IBM (40% of revenue) may not be growing as fast as it had been in previous quarters and that IBM may have some inventory building throughout its organization. As such investors seem concerned with future earnings potential. Management has indicated that it feels comfortable with the IBM relationship and current demand, and it has not changed financial guidance for the year.
(Appendix, Ex. 25; Compl. ¶ 109.)

7. April 19, 1995 Press Release:

Driven by strong performances in its reseller channels and continued customer acceptance of the company's products and overall technology direction, [Chipcom] today announced record sales for the first quarter of its 1995 fiscal year, ended April 1. [reporting revenues of $86.21 million, a 66% increase over the first quarter of 1994, and net income of $8 million, or $0.45 per share, a 300% increase over the first quarter of 1994.]
(Appendix, Ex. 26; Compl. ¶¶ 111, 112.)

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[12] I note that plaintiffs' Complaint makes material omissions when compared to the original document now supplied in the Appendix.

8. <u>April 19, 1995 Conference Call with Analysts</u>:

a. **<u>Badavas Statements to Analyst</u>**
Gross margins in the quarter [Q1 1995] of 52.7% was fully <u>in line with our expectations</u> and our guidance . . . Distribution [to] IBM in the quarter, $30.6 million [was] fully in line with our guidance as of the February conference call . . . .
(Appendix, Ex. 27; Compl. ¶ 32.)

b. I would nominally say at this point that it is <u>our expectation based on what we know now</u> that our sequential shipment stream to IBM <u>will be down approximately 20% from its first quarter level</u>. To do the arithmetic, that says that we are in the <u>$24 million range</u> in the second quarter.
(Appendix, Ex. 27; Compl. ¶¶ 36, 116.)

c. **<u>Held Statements to Analysts</u>**
<u>IBM did get off to a slow start</u> from a sales point of view during the early part of the year, that and mix issues . . . which result from the transition of products from 8250 to 8260 has <u>resulted in an imbalance in the IBM inventory position</u> which does mean that we do expect that in <u>all probability we will be reducing our Q2 IBM</u> shipments to rebalance, to give them a chance to rebalance their inventory, <u>a problem which we expect to be by us by the end of Q2</u>.
(Appendix, Ex. 27; Compl. ¶ 114.)

d. [T]he product transition from 8250 to 8260 business has created an imbalanced inventory position at IBM. This <u>will in all probability mean reducing our Q2 IBM shipments to rebalance</u>, to give them a chance to rebalance their inventory. <u>We expect by the end of Q2 IBM will be back on track and in balance</u>. This reduction is being nicely picked up by steady healthy growth in our trade channels.
(Appendix, Ex. 27; Compl. ¶¶ 35, 108.)

B. Additional Statements By Defendants

In addition to the allegedly actionable statements, plaintiffs refer to the following public statements by defendants:

1. <u>May 12, 1995 10-Q Report</u>:

[R]evenue derived from IBM <u>during the second quarter</u> of 1995 <u>will be below</u> the level reported in the first quarter <u>due to an inventory imbalance</u> that <u>currently exists</u> within IBM.
(Compl. ¶ 133.)

2. <u>May 26, 1995 Press Release (Held Statement)</u>:
[There will be] lower shipment levels to IBM . . .

consequently, Chipcom's revenue expectations for the second quarter and the year will be reduced.
(Compl. ¶ 136.)

3. May 26, 1995 Conference Call to Analysts:
[Announcing IBM second quarter revenue projection of about $15 million, 50% down from first quarter results, and a yearly earnings projections almost 50% lower than April 6, from $2.00 per share to $1-$1.30 per share.]
(Compl. ¶ 138.)

a. Held Statement:
Our revenue shortfall seems to be directly related to a major reorganization that happened in IBM early in 1995 in the field, the networking sales specialists in the U.S. which we had trained in 1993 and 1994 were disbursed throughout the general salesforce and apparently this caused a drop in activity which showed up as a reduction in the pipeline for new order. The pipeline from Q3 to Q4 1994 activity carried us in Q1 [1995], but apparently was quite dry by the end of Q1.
(Compl. ¶ 139; 71.)

b. Badavas Statement:
[IBM] does not currently sell ONsemble . . . they will begin selling ONsemble in the second half of the year.
(Compl. ¶ 118.)

C. Additional Statements By Analysts

In addition to the allegedly actionable Business Wire (A4) and Robertson Stephens (A6) statements, plaintiffs refer to certain other third-party statements:

1. February 10, 1995 Boston Business Journal:

[Noting the high percentage of Chipcom sales through IBM was sparking industry speculation that IBM would buyout Chipcom].
(Compl. ¶ 93(a).)

2. February 15, 1995 Computergram International:

[Chipcom and IBM] are getting so co[z]y [that IBM may be acquiring Chipcom].
(Compl. ¶ 93(b).)

3. February 15, 1995 PaineWebber Statement:

[Announced an extension of Chipcom's relationship with IBM, IBM's agreement to take Chipcom's new stackable hubs and switching hubs, and a resulting $10 million increase in IBM's contribution to Chipcom's revenues.]

> The signing of an extended relationship with IBM . . . will sustain 30-40% revenue growth in the IBM channel in 1995. Non-IBM channels are still very healthy (estimated 64% growth in 1995) and the faster growth here would normally lead to improving gross margins. . . . More important, the extension of the relationship signals no wavering in IBM's commitment to CHPM . . . interdependencies are building between both parties . . . .
> (Compl. ¶¶ 150(b), 93(c).)

4. April 20, 1995 Cowen & Co. Statement:

> Chipcom [attributed the inventory imbalance] to IBM's forecasting process which resulted in orders ahead of their customer's requirements. . . . Chipcom expects IBM inventory levels to normalize in 2Q . . . .
> (Compl. ¶¶ 37, 130.)

5. April 20, 1995 NatWest Statement:

> The key issue in the quarter was the IBM relationship, and an inventory problem . . . which will result in lower sequential shipments to IBM in 2Q. The company indicated that inventory of specific modules . . . are currently in oversupply at IBM, and projects that it will take several months to work through the inventory. . . . The company indicated that the reason for the inventory imbalance was related to IBM's internal planning over the last two quarters. . . . Although we are concerned by the buildup of inventory at IBM, we believe that much of this concern is already reflected in the price of the stock and that there is a credible scenario for a turnaround in the second half.
> (Compl. ¶¶ 124, 125, 130.)

6. April 20, 1995 Robertson Stephens & Co. Statement:

> [I]nvestors have been very concerned recently about Chipcom's relationship with IBM. The concerns ranged rom a complete falling apart of the relationship to too high of inventories in the IBM channel . . . On the analysts' conference call . . . management stated that IBM does have too much inventory of the current generation intelligent hubs (IBM 8250) and that it will take at least one full quarter to work through the problem.
> (Compl. ¶ 123.)

7. April 20, 1995 PaineWebber Statement:

> The company indicated that while shipments may be down as much as 20% in Q2, CHPM felt it could rectify the IBM problem by the end of Q2.
> (Compl. ¶¶ 37, 122.)

8. <u>May 30, 1995 Robertson Stephens & Co. Statement</u>:

> [after stating that they would be lowering their investment recommendation . . .] It is very hard for us to conceive of demand for these products dropping so precipitously in such a short time period. We can only conclude that either the shipment levels in 1994 were significantly higher than end demand, therefore the inventory problem is much greater than described or IBM's reselling of the next generation 8260 (Chipcom's ONcore) is not going as well as Chipcom would have hoped.
> (Compl. ¶ 144.)

9. <u>June 7, 1995 Wall Street Journal Article Entitled, "Chipcom Shares Dumped Prior to IBM's News"</u>:

> [Chipcom spokesperson] says the information was released in a 'timely fashion.' . . . But an IBM spokesman was less certain. He said there were several meetings between IBM and Chipcom officials 'earlier in the year' at which the developing problems were discussed.
> (Sahid Declaration, Ex. 1; Compl. ¶¶ 6, 71, 142-143.)

D. Internal Projections

The Complaint sets forth the following internal projections for revenues (in millions):

<u>1995</u>	<u>Second Quarter (IBM)</u>	<u>1995 (IBM)</u>	<u>Total</u>
January 16, 1995	$37	148	430.5
February 6, 1995	$30	127.7	382
March 3, 1995	$22	128	421
March 6, 1995	$22	129.7	422.7
March 17, 1995	$32[13]	129	380
April 19, 1995*	$24	--	--
April 26-27, 1995	$24 ($2.4 from ONsemble)	109.1	370.7
May 26, 1996*	$15	--	330-350

*made public

[13] I note that plaintiffs assert in the Complaint that the March 15 second quarter projection was $22, presumably to bolster their contention that Chipcom knew throughout March--and failed to disclose--that IBM's second quarter revenues would be significantly lower than the first quarter. (Compl. ¶ 87.) However, the March 17 internal projection document submitted by plaintiffs to particularize this allegation shows a figure of $32 million, substantially undermining this argument. (Appendix, Ex. 20.)

(Appendix, Exs. 1, 2, 15, 16, 20, 33, 35, 42; Compl. ¶ 87.)

In addition, plaintiffs refer to the following non-public statement captured in an April 5, 1995 internal memorandum. The memorandum comments on historical facts, and, in general terms, projections for the first quarter:

1. April 5, 1995 Internal Memorandum:

> We met today with IBM to review Q1 volumes. Since the recent drop in our stock price has been attributed by many to softness in our IBM business, it is important that we understand the real numbers. . . . The 1Q95 numbers are partial because they do not include all March shipments. . . . When shipments to US, Canada, Latin America and Asia/Pacific are added, the 1Q95 results should go up at least 25%. The point is that year-to-year growth is strong. Quarter-to-quarter results show a decline that reflects the normal seasonality of IBM business. The 8250 is on-track against the seasonal plan, while the 8260 is somewhat behind, but not disastrously so. 8260 volumes in 1Q95 were negatively affected by numerous problems in the new token ring products. IBM does not track shipments to internal IBM customers, which were very strong in 1Q95. . . . The point is that IBM's hub business is reasonably healthy. . . . it could be a lot better, it they assign better sales people to networking. We are working hard to convince them to do this.
> (Appendix, Ex. 23; Compl. ¶ 103.)

E. **Alleged Insider Trading**

Finally, the Complaint details alleged trading by the individual defendants during the class period:

Insider	Date	# Shares	Sold Price
Menachem Abraham	2/10/95	17,155	$45.75
John Held	2/10/95	10,000	$45.75
Robert Badavas	2/10/95	10,000	$46.00
John Meyer[14]	2/10/95	10,000	$46.50
Bruce Cohen	2/16/95	15,000	$42.875
Jerald Fishman	3/09/95	500	$42.50
	3/10/95	500	$43.00
	3/10/95	500	$43.38
	3/17/95	2,000	$43.50
Menachem Abraham	4/26/95	12,000	$30.00
Bruce Cohen	4/27/95	6,000	$32.00
	4/27/95	9,000	$32.25
John Held	4/27/95	2,000	$32.25
	4/27/95	4,000	$32.00
Robert Badavas	4/28/95	10,000	$31.88
John Held	4/28/95	4,000	$31.75

Totals:	Shares Sold	Proceeds	Est. Profits[15]
Menachem Abraham	29,155	$1,144,841[16]	
Bruce Cohen	30,000	$1,250,000	>$580,000
Robert Badavas	20,000	$778,800[17]	>$530,000
John Held	20,000	$777,000	>$475,000
Jerald Fishman	3,500	$151,440	
John Meyer	10,000	$465,000	
	112,655	$4,567,081[18]	

(Compl. ¶¶ 8, 17-23, 150-51.)

[14]I note that John Meyer, Vice President of Human Resources, is *not* a named defendant. Meyer sold 10,000 shares on February 10, 1995 realizing proceeds of $465,000. He then purchased 10,000 shares on the same day for approximately $187,000, a gain at sale of over $278,000. (Compl. ¶ 23.)

[15](Compl. ¶¶ 17-22.)

[16]This figure is based on the 17,155 figure indicated in ¶¶ 150(a)(ii) and 151 of the Complaint. Elsewhere, it appears that plaintiffs have used the figure 17,500, producing a total number of shares sold of 29,500 and total proceeds of 1,160,625 (see ¶ 8, 20). In addition, the 17,155 figure, which I employ, produces a grand proceeds total of $4,567,081. (Cf. Compl. ¶ 29.)

[17]Plaintiffs inadvertently indicate the total as $778,000.

[18]Cf. $4,517,815 (Compl. ¶ 29.)

III.

In reviewing the motion to dismiss, I "take the allegations in the complaint as true and must make all reasonable inferences in favor of the plaintiffs." Watterson v. Page, 987 F.2d 1, 3 (1st Cir. 1993) (citing Monahan v. Dorchester Counseling Ctr., 961 F.2d 987, 988 (1st Cir. 1992)). Furthermore, I may grant dismissal only if "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." Roeder v. Alpha Indus., 814 F.2d 22, 25 (1st Cir. 1987) (quoting Conley v. Gibson, 355 U.S. 41, 45-46 (1957)).

A. Section 10(b) and Rule 10b-5

Count I alleges violations of § 10(b), and corresponding Rule 10b-5, of the Securities Exchange Act of 1934, against *both* Chipcom and the individual defendants. Section 10(b) makes it unlawful:

> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). In conjunction, Rule 10b-5, promulgated by the Securities and Exchange Commission, further provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to

> defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (emphasis added).

In order to state a claim under § 10(b) and Rule 10b-5, the plaintiffs must show that: (1) the defendants made a misrepresentation or omission of material fact, (2) with scienter, (3) upon which the plaintiffs relied, (4) and that caused damages to the plaintiffs. Van De Velde v. Coopers & Lybrand, 899 F. Supp. 731, 734 (D. Mass. 1995) (citing Basic v. Levinson, 485 U.S. 224, 230-32 (1988)). A material fact is one that is "likely to be viewed by the reasonable investor as significantly altering the total mix of available information." Colby v. Hologic, Inc., 817 F. Supp. 204, 209 (D. Mass. 1993) (citing TSC Indus., Inc. v. Northway, 426 U.S. 438, 445 (1976)); Lucia v. Prospect St. High Income Portfolio, Inc., 36 F.3d 170, 175 (1st Cir. 1994). The Supreme Court has defined the scienter requirement as "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194, n.12 (1976).

In addition, Rule 9(b) of the Federal Rules of Civil Procedure requires that the plaintiffs state all allegations of fraud, such as those presented here, with particularity. Fed. R. Civ. P. 9(b). The First Circuit strictly construes this

requirement in the securities fraud context:

> [G]eneral averments of the defendants' knowledge of material falsity will not suffice. Consistent with Fed.R.Civ.P. 9(b), the complaint must set forth 'specific facts that make it reasonable to believe that defendant[s] knew that a statement was materially false or misleading.' The rule requires that the particular 'times, dates, places or other details of [the] alleged fraudulent involvement' of the actors be alleged.

Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d 357, 361 (1st Cir. 1994) (citations omitted).[19] If the allegations of fraud are based upon information and belief, the complaint must state "the source of the information and the reasons for the belief." Romani v. Shearson Lehman Hutton, Inc., 929 F.2d 875, 878 (1st Cir. 1991). The plaintiffs must meet these requirements even if the "fraud relates to matters peculiarly within the knowledge of

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[19]Contrary to defendants' allegation, plaintiffs do not argue that "notice pleading" is the correct standard. Plaintiffs merely rely on First Circuit cases, such as Wayne Investment, Inc. v. Gulf Oil Corp., 739 F.2d 11, 13 (1st Cir. 1984), which link particularity to notice. For example, Wayne describes the "special pleading requirement" of "particularity" as "provid[ing] the defendant with notice of the grounds on which plaintiff's *fraud claim rests*." Id.

Defendants correctly argue that the roles of the individual defendants must also be particularized, Manchester Manufacturing Acquisitions, Inc., v. Sears, Roebuck & Co., 802 F. Supp. 595, 600 (D.N.H. 1992), in order to insure that officers and directors are not sued solely on the basis of status, Loan v. Federal Deposit Ins. Corp., 717 F. Supp. 964, 968 (D. Mass. 1989), and so that each defendant is given notice of his specific alleged role. Konstantinakos v. Federal Deposit Insurance Corp., 719 F. Supp. 35, 38 (D. Mass. 1989). Here, unlike the facts in Loan and Konstantinakos, plaintiffs have attributed specific statements to defendants Held, Badavas, and Abraham (but not to Cohen or Fishman.) However, as discussed below, while individual roles may be particularized, the statements are not actionable.

the opposing party." Id.; Lucia, 36 F.3d at 174. "To survive a motion for dismissal [] a complaint must contain, at a minimum, 'factual allegations that would support a reasonable inference' that 'circumstances adverse' to the defendant's statements 'were known and deliberately or recklessly disregarded' at the time the statements were made." Colby, 817 F. Supp. at 210 (citing Romani, 929 F.2d at 878.)[20]

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[20] I note, but do not here rely upon the fact, that the pleading standard has recently been heightened by the December 22, 1995 enactment--overriding the President's veto--of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 101(b), 109 Stat. 737, 747 (to be codified at 15 U.S.C. § 78u-4). Section 101(b), adding a new section 21D to the Securities Exchange Act of 1934, was designed to conform to Rule 9(b), to resolve differences within the circuits, and to strengthen existing pleading requirements--following but not codifying the pleading standard of the Second Circuit. Conf. Rep. No. 104-369, 104th Cong., 1st Sess. (1995).

Although not applicable to pending actions (see § 108) such as this, Section 101(b) provides that a complaint should be dismissed if the requirements of paragraphs (1) and (2) are not met:

> (1) MISLEADING STATEMENTS AND OMISSIONS--In any private action arising under this title in which the plaintiff alleges that the defendant--
>
> (A) made an untrue statement of a material fact; or
>
> (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.
>
> (2) REQUIRED STATE OF MIND--In any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint

In this case, plaintiffs argue that a reasonable inference can be drawn from the close relationship with IBM (including the meeting and review process), the internal projections, the extent of insider trading, as well as statements by defendants and outsiders, that defendants knew *before* May 26--as well as before April 19--that second quarter IBM revenue would be significantly lower. Thus, plaintiffs argue for a contextual analysis of all proffered facts, see McMahan & Co. v. Wherehouse Entertainment, Inc., 900 F.2d 576, 579 (2d Cir. 1990), cert. denied, 501 U.S. 1249 (1991), while defendants analyze and dismiss the statements individually.

1. Alleged Actionable Statements

As discussed above, the Complaint contains numerous statements of varying types by defendants--historical summaries, predictions, puffery--as well as statements by third parties. However, analyzed individually, I find none of the allegedly actionable statements supports a cause of action.

First, with respect to historical statements, "defendants may not be held liable under the securities laws for accurate

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> shall, with respect to each act or omission alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

§ 101(b) (emphasis added).

The Act does not specify the required state of mind, and a Conference Committee amendment was rejected which would have incorporated the Second Circuit's standard of allowing a "strong inference" to be demonstrated by particularized pleadings of motive, opportunity or recklessness. See, e.g., San Leandro, 75 F.3d at 813; Conf. Rep. No. 104-369, 104th Cong., 1st Sess. (1995).

reports of past successes, even if present circumstances are less rosy." Serabian, 24 F.3d at 361; Capri Optics Profit Sharing v. Digital Equipment Corp., 950 F.2d 5, 8 (1st Cir. 1991) (accurate past results not actionable). See also In re Caere Corporate Securities Litigation, 837 F. Supp. 1054, 1058 (N.D. Cal. 1993) (historical statements "contain no implicit prediction that those events or conditions will continue in the future").

Second, "optimistic predictions about the future that prove to be off the mark likewise are immunized unless plaintiffs meet their burden of demonstrating intentional deception." Serabian, 24 F.3d at 361 (citations omitted); Capri Optics Profit Sharing, 950 F.2d at 11 (finding "well poised [for the next quarter]" no promise of future success and thus not actionable). In Serabian, the First Circuit stated that a defendant could, for example, state: "'This is our eighth consecutive quarter in which our gross has increased,' [without the] duty to add, for the benefit of market buyers, 'We are concerned about the next one.'" Id. at 361, n.4. The First Circuit explained, however, that the rule might be different if "defendant's apprehension was of a disaster." Id. (citation omitted.) See also In re Healthcare Compare Corp. Securities Litigation, 75 F.3d 276, 281 (7th Cir. 1996) ("forward-looking statements need not be correct; it is enough that they have a reasonable basis") (citation omitted).[21]

[21]The Private Securities Litigation Reform Act of 1995 (see above n. 20) appears also both to clarify and heighten the pleading and proof requirements for forward-looking statements, by adding a new section 21E to the Securities Exchange Act of

Similarly, vague and general positive comments--"puffery"--concerning the present or future are not actionable. Serabian, 24 F.3d at 361 ("look[ing] to the future with great optimism" is "clearly inactionable puffing") (citation omitted). See also San Leandro Emergency Medical Group v. Philip Morris Companies, 75 F.3d 801, 811 (2d Cir. 1996) (vague statements not actionable because no reasonable investor would rely on them); Gross v. Summa Four, Inc., No. C-94-364-B, 1995 WL 806823 at *10 (D. N.H. Nov. 8, 1995) (same); Rand v. Cullinet Software, Inc., 847 F. Supp. 200, 208 (D. Mass. 1994) (finding statements "optimistic about the year ahead" and "long term prospects bright" not actionable) (citing cases).

Analyzed individually none of defendants' statements are actionable.[22] Historical statements are found in A1(b) ("IBM-Chipcom relationship has been mutually beneficial from day one");

1934. Again, I note--although I do not treat as operative in this case commenced before the effective date of the Act--that section 102(b) of the Act creates a "safe harbor" for forward-looking statements that are:

(A) (i) identified as forward-looking and accompanied by meaningful cautionary statements or
(ii) immaterial; or
(B) (i) made by a natural person who did not have actual knowledge that the statements were false or misleading; or
(ii) made by a business entity, by or with the approval of an executive officer, who did not have actual knowledge that the statements were false or misleading.

See § 102(b).

[22] I will refer to the statements by the letter and number denoting the statements in section II above.

A3 ("third-party relationships were important"); A5(c) ("[IBM channel] has been very, very successful" . . . "very happy with [performance] overall" . . . "year-to-year growth has been very strong"); A5(d) ("performance [in 1Q95] for both products was substantially higher [than 1Q94]"); A7 and A8(a) (reporting 1995 first quarter results); and A8(c) (transition "has resulted in an imbalance in the IBM inventory position").

Future-oriented comments are found in A4 ("revenue for [1Q95] expected to be approximately $86 million"); A5(a) ("expects to have another very good year" . . . "forecasting . . . $370 million revenue range. . . for the year"); A8(b) ("our expectation . . . $24 million range in the second quarter"); A8(c) ("expect to be by [inventory problem] by the end of Q2"); and A8(d) ("by the end of Q2 IBM will be back on track and in balance . . . reduction is being nicely picked up by steady healthy growth in our trade channels").[23]

Finally, general, positive statements, describing the present and future relationship with IBM are found in A1(a) ("significant multiyear expansion"); A2(b) ("excellent foundation" . . . "exciting product development activities"); A3 ("important" . . . "continue our expansion"); A5(b) ("continues to be a very important relationship"); A5(d) ("[transition to new products] going very well . . . in any transition you have to be

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[23]Moreover, based on Chipcom's internal projection charts submitted by plaintiffs in the Appendix, Chipcom believed that 1995 would, generally, be a successful year, consistent with the $370 million public projection. (See above section II(D).)

very careful about how you manage the stock"); and A6 ("management has indicated that it feels comfortable with the IBM relationship and current demand").[24]

Plaintiffs argue that defendants' use of the word "strong"

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[24]Moreover, the analyst statement (A6), is also not actionable because there is insufficient allegation of entanglement. In general, where "defendants are alleged only to have authorized or acquiesced in [statements] . . . or they are attributed no role at all in the dissemination of the statements," the requirements of Rule 9(b) have not been met. Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d 357, 368 (1st Cir. 1994). Similarly, the Second Circuit has concluded that dismissal of imputed statements is appropriate unless a defendant

> sufficiently entangled itself with the analysts' forecasts to render those predictions attributable to it . . . [by placing] its imprimatur, expressly or impliedly, on the analysts' projections.

Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163 (2d Cir. 1980). See also Raab v. General Physics Corp., 4 F.3d 286, 287 (4th Cir. 1993) ("The securities laws require [the company] to speak truthfully to investors; they do not require the company to police statements made by third parties for inaccuracies, even if the third party attributes the statement to [the company]"); In re Caere Corporate Securities Litigation, 837 F. Supp. 1054, 1059-60 (N.D. Cal. 1993) (sufficient entanglement occurs, for example, when a defendant has reviewed the analysts' statements *and* made an implied representation that the information is true).

Plaintiffs assert that defendants routinely communicated with several securities firms including PaineWebber, Robertson Stephens & Co., NatWest Securities, and Cowen & Co. (Compl. ¶ 30), and that routine conference calls followed a "standard format" of giving "pre-release" guidance on operations and financial prospects. (Compl. ¶¶ 31-33.) Plaintiffs argue that "defendants made these communications in order to cause or encourage them to issue favorable reports concerning Chipcom and . . . to falsely present the operations and prospects of Chipcom to the marketplace in a favorable light and to artificially inflate the market price of Chipcom's common stock." (Compl. ¶ 31.) However, while plaintiffs have alleged facts of "guidance" (see Compl. ¶¶ 30-33, 37, 109), they have alleged facts of ratification only in A5(a).

in certain future-oriented statements goes beyond mere puffery: A1(b) (multiyear extension "strengthens our already strong alliance with IBM"); A2(a) ("three-company relationship builds on Chipcom's already strong and recently expanded strategic alliance with IBM"); and A3 ("alliance with IBM [ ] remains strong and mutually beneficial").

Not surprisingly, the adjective "strong" frequently appears in challenged statements, but the weight of authority finds that such language is mere puffery in a context like that alleged here. See, e.g., San Leandro, 75 F.3d at 805-807, 811 ("expecting a strong year" . . . "Marlboro is still very strong in the face of very low pricing" . . . "the tobacco business is strong and growing" . . . "We expect 1993 to mark another year of strong growth in earnings per share" . . . "we expect to maintain a strong competitive position in the discount category"); Searls v. Glasser, 64 F.3d 1061, 1067 (7th Cir. 1995) ("[we] anticipate continued strong demand for tire products") (quoting Cione v. Gorr, 843 F. Supp. 1199, 1205 (N.D. Ohio 1994)); Capri Optics, 950 F.2d at 11 ("international business . . . remains strong"); Fisher v. Acuson Corp., No. C93-20477RMW, 1995 WL 261439 at *4 (N.D. Cal. April 26, 1995) ("[the new product establishes] a strong platform"); Gross, 1995 WL 806823 at ** 2-3, 8 ("strong financial position" . . . "business is very strong" . . . "business remains strong"); In re Syntex Corp. Securities Litigation, 855 F. Supp. 1086, 1096 (N.D. Cal. 1994) ("[we expect] a very strong fiscal 1993"); In re Ross Systems

Securities Litigation, No. C-94-0017-DLJ, 1994 WL 583114 at *8 (N.D. Cal. July 21, 1994) ("strong" . . . is example of "vaguely worded expectation"); In re Caere Corporate Securities Litigation, 837 F. Supp. at 1057-1058 ("continuing strong sales").[25]

Plaintiffs urge consideration of McCarthy v. C-Cor Electronics, Inc., 909 F. Supp. 970 (E.D. Pa. 1995). In McCarthy, the plaintiffs alleged that the following press release was actionable:

> Looking ahead, we expect strong revenues for the second half of the year, although in the third quarter, the earnings are expected to reflect the start-up costs for Reedsville. We anticipate a strong fourth quarter and continue to have a record backlog.

909 F. Supp. 974-75. Judge Pollak denied the motion to dismiss, finding that the reference to "strong revenues" there was *not* inactionable "puffing." However, while rejecting the approach of the Fourth and Fifth Circuits--that predictions are immaterial unless worded as guarantees, id. at 976-77 (citing Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993); Krim v. BancTexas Group, Inc., 989 F.2d 1435, 1446 (5th Cir. 1993))--the McCarthy court explained that each prediction must be given independent analysis. The court listed factors to consider,

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[25] Cf. Serabian, 24 F.3d at 364-365 (denying motion to dismiss when sufficient facts showed internal knowledge of problems *combined with* public statements describing capabilities as "strong"); Shapiro, 964 F.2d at 283 (finding collection of statements which specifically addressed loan loss reserves--including "adequate," "adequately maintained," "strong," and "solid"--properly stated claim).

e.g.: 1) the specificity of the prediction ("strong demand" being more vague than "strong revenues"); 2) how far into the future the prediction extends ("long term predictions are necessarily less reliable"); and 3) the degree to which the prediction is inherently difficult or unreliable, for example the success of a merger. McCarthy, 909 F. Supp at 977. Judge Pollak found that the statement at issue--which specifically addressed "strong *revenues*," looked into the future only three to six months, and involved the prediction of revenues which are "susceptible to somewhat reliable prediction"--was sufficient to state a claim. Id.

In sharp contrast, defendants' alleged statements incorporating the word "strong" are much less specific, each relating to the vague word "alliance."[26] Second, the statements look much farther into the future ("multiyear expansion") (see A1(a)). Third, the success of an "alliance" is inherently more difficult to measure with specificity than is the success of revenues. Thus, I find McCarthy supports defendants' argument that the statements here involving "strong" are not actionable.[27]

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[26]In fact, the only references to "strong" as applied to "revenues" are found in arguably historical statements: D1 ("[Y]ear-to-year growth is strong; "shipments to internal IBM customers [] were very strong in 1995"); and A7 (1Q95 results "driven by strong performances in its reseller channels").

[27]Moreover, as in Rand, defendants' claim of a "strong alliance," without guaranteeing the future, rested on solid evidence of a very close relationship. Rand v. Cullinet Software, Inc., 847 F. Supp. 200, 212 (D. Mass. 1994) ("customer acceptance of our products remains strong").

Plaintiffs also urge consideration of Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1090-95 (1991) (holding that knowingly false statements of belief or opinion, such as "high" value or "fair" price, may be actionable under 10(b)). However, as Rand has noted, Virginia Bankshares does not automatically transform puffery into an actionable statement. Rand, 847 F. Supp. at 208 (D. Mass. 1994). The key factor is whether a reasonable investor would have considered the statement important in initiating or continuing the investment. Id. Similarly, McCarthy recognized that even if language is as vague as that in Virginia Bankshares, a *case-by-case* analysis should be employed. McCarthy, 909 F. Supp. at 976. Thus, Virginia Bankshares holds only that if a reasonable investor would rely on the prediction then it would be actionable if false or misleading. Here, because the statements were so vague, they cannot, in turn, be actionable. See Gross, 1995 WL 806823 at * 10; Capri Optics, 950 F.2d at 10; Cione, 843 F. Supp at 1203.

Furthermore, in connection with certain of the allegedly actionable statements, the defendants did provide cautionary statements on April 6, 1995 ("[T]he exact balance between these two products is always a little hard for forecast. IBM is [] moving through the transition as are we . . . in any transition [you] have to be careful how you manage the stock") (see A5(d)), and on April 19, 1995 ("it is our expectation based on what we know now that our sequential shipment stream to IBM will be down

approximately 20% from its first quarter level" . . . "IBM did get off to a slow start" . . . "resulted in an imbalance in the IBM inventory" . . . "in all probability we will be reducing our Q2 IBM shipments") (see A8(b)(c)). Even the statement "we are very happy with the way it's performing overall" (see A5(c)), implies a consideration of the "whole picture"--both positive and negative factors--and was fully consistent with yearly projections. Thus, as the Second Circuit explained in San Leandro:

> the forward looking statements regarding projected [ ] earnings reflect hope, adequately tinged with caution, and that the total mix of information available to the market cannot reasonably be found to be misleading. . . . In any event, even the most positive statements by Philip Morris representatives at that time consisted of relatively subdued general comments . . . such puffery is not actionable.

San Leandro, 75 F.3d at 811.

2. Duty to Disclose

Ultimately, plaintiffs argue that it is the failure *to disclose information in conjunction with the above statements* which is actionable. A duty to disclose "does not arise from the mere possession of nonpublic market information." Chiarella v. United States, 445 U.S. 222, 235 (1980). But companies must disclose material information if there is a duty to disclose it. Roeder, 814 F.2d at 26. "When a corporation does make a disclosure--whether it be voluntary or required--there is a duty to make it complete and accurate." Id. (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860-61 (2d Cir. 1968), cert. denied,

394 U.S. 976 (1969)). Thus, even statements that are literally true may be actionable because of a failure to disclose:

> Some statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. For that reason, the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers.

Lucia, 36 F.3d at 175 (citation omitted).

However, when a duty to disclose arises, only material information must be disclosed, pursuant to the requirements of a § 10(b) action. This is information which "a reasonable investor might have considered important in the making of [the investment] decision." Roeder, 814 F.2d at 25. This "does not mean that by revealing one fact about a product, one must reveal all others that, too, would be interesting, market-wise . . . ." Backman v. Polaroid Corp., 910 F.2d 10, 16 (1st Cir. 1990).

Furthermore, it is axiomatic that there can only be a duty to disclose if there is *knowledge* of something requiring disclosure. This brings the analysis back to the threshold issue of particularity: whether there are facts sufficient to show knowledge. It is clear in this connection that knowledge may be inferred from other facts. Serabian, 24 F.3d at 365 (finding auditor's and consultants' reviews permitted inference that the bank knew, or should have known, that its statements were inconsistent); Steiner v. Unitrode Corp., 834 F. Supp. 40, 44-45 (D. Mass. 1993) (denying motion to dismiss due to inference of knowledge). See also Goldman v. Belden, 754 F.2d 1059, 1070 (2d

Cir. 1985) (finding complaint stated claim where knowledge could be inferred from a variety of facts).

Defendants argue that there was no duty to disclose because defendants had no direct or indirect knowledge, and that plaintiffs are relying solely on the "hindsight theory." It is "well established that plaintiffs in a securities action have not alleged actionable fraud if their claim rests on the assumption that the defendants *must have known* of the severity of their problems earlier because conditions *became so bad later on.*" Serabian, 24 F.3d at 367 (emphasis added). See also Greenstone v. Cambex Corp., 975 F.2d 22, 25-26 (1st Cir. 1992); Berliner v. Lotus Development Corp., 783 F. Supp. 708, 710 (D. Mass. 1992) (finding conclusionary allegations of knowledge insufficient to state claim).

Plaintiffs steadfastly argue that they are not relying on the hindsight theory, but rather on *facts* which show a reasonable inference that defendants had the requisite knowledge before April 19, 1995. These facts consist of 1) the alleged actionable statements, 2) defendants' internal projections, 3) insider trading, 4) additional statements by third-parties, and 5) the meeting and review process with IBM. I decline to accept plaintiffs' argument.

First, the allegedly actionable statements, as analyzed above, have been shown not to be actionable when considered separately. Second, defendants have no duty to reveal internal

projections or marketing plans.[28] Wilensky v. Digital Equipment Corporation, 903 F. Supp. 173, 177, 181 (D. Mass. 1995); Vaughn v. Teledyne, 628 F.2d 1214, 1221 (9th Cir. 1980) (finding no duty to disclose projections).[29] But see San Leandro, 75 F.3d at 810

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[28]The defendants similarly have no duty here to disclose known trends, despite securities regulations cited by plaintiffs. (Compl. ¶¶ 24, 88.) For example, Rule 303 states that in filing periodic reports with the SEC, the company must:

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues . . . the change in the relationship should be disclosed.

17 C.F.R. § 229.303(a)(3)(ii). But see 17 C.F.R. § 229.303(a) (Instruction 7) ("Registrants are encouraged but not required to supply forward looking information. . . .")

These requirements do not on their own support plaintiffs' private cause of action. Wilensky v. Digital Equipment Corporation, 903 F. Supp. 173, 181 (D. Mass. 1995) (finding that even the "relevance of Item 303 violation to a 10b-5 suit remains subject to some dispute"). See also Greenstone v. Cambex Corp., 975 F.2d 22, 26-27 (1st Cir. 1992) (finding plaintiff did not adequately specify facts to find liability on known trend grounds where complaint alleged company's knowledge in only general terms).

[29]Although a partial disclosure of a projection may require additional disclosures to ensure completeness and accuracy, Vaughn v. Teledyne, 628 F.2d 1214, 1221, n.7 (9th Cir. 1980), defendants made no public projections for the second quarter of 1995 *before* April 19, 1995. The April 6, 1995 statements by Held (A5)--limited to a yearly projection and other vague puffery--avoided making a prediction for the second quarter. In fact, cautionary statements were made concerning the product transition. A favorable longterm projection does not require disclosure of an upcoming quarter. See, e.g., In re Caere Corporate Securities Litigation, 837 F. Supp. at 1058. Moreover, I do not find these general future predictions actionable because there are no facts which indicate deception (e.g., that the

(cautioning that marketing plans are not *per se* immaterial, rather "duty to disclose" is the critical question). In any event, I do not find that the internal projection of $22 million for Q295 during early March--notwithstanding the March 17 estimate of $32 million--was materially different from the April 19, 1995 projection of "the $24 million range." Plaintiffs have offered no facts to show that the defendants had knowledge *prior to May 26* that the projection would dip to $15 million.[30]

Third, as discussed above, the statements allegedly made by analysts are not separately actionable because they are either repetitive of defendants' statements, equally vague, or because they are not attributable to the defendants. More particularly, the statement quoted in the Wall Street Journal (C9), despite being referred to six times by plaintiffs in their Opposition Memorandum and numerous times in the Complaint, is not actionable because the statement notably fails to meet the particularity standard. Not only is the statement unattributed to an

---

defendants knew that the second quarter of 1995 was going to be a "disaster"). Serabian, 24 F.3d at 361, n.4. The April 5, 1995 internal memorandum (D1), discussing "numerous problems," is not sufficiently particular to equate with "disaster." Indeed, plaintiffs unfairly truncate the statement from the original document, omitting language such as "reasonably healthy," and that while quarter-to-quarter results showed a decline, it was "not disastrously so." Moreover, the memorandum labels the figures as "partial" for various reasons. (Appendix, Ex. 23.)

[30] Plaintiffs' reliance on Kirby v. Cullinet Software, Inc., 721 F. Supp. 1444, 1451-53 (D. Mass. 1989), is inapposite. Moreover, in contrast to In re Lotus Development Corp., 875 F. Supp. 48, 52 (D. Mass. 1995), on which plaintiffs also rely, here the defendants admitted rather than denied potential problems, and adjusted projections accordingly.

identifiable person, but it is anonymously attributed to an IBM, rather than Chipcom, official. See Time Warner Inc. Securities Litigation v. Ross, 9 F.3d 259, 265-66 (2d Cir. 1993), cert. denied sub nom. 114 S. Ct. 1397 (1994) (finding caselaw supports dismissal of completely unattributed statements).

Fourth, I recognize that "insider trading in suspicious amounts or at suspicious times, of course, could help the [plaintiffs]." Greenstone, 975 F.2d at 26 (citing In Re Apple Computer Securities Litigation, 886 F.2d 1109, 1117 (9th Cir. 1989), cert. denied, 496 U.S. 943 (1990) (trading may be probative when "dramatically out of line with prior trading practices")); Topogna v. Egan, 141 F.R.D. 370, 373 (D. Mass. 1992) (sale of stock may support inference of fraud). However, plaintiffs fail to plead with particularity--or even generally--the amount of trading normally conducted by these individuals, including the sale of exercised options. Thus, comparisons with prior practices are impossible.

Finally, plaintiffs set forth the organizational structure for meetings between Chipcom and IBM, as called for in the original Alliance Agreements. (See above, section II.) However, plaintiffs again rely on conclusory statements, without facts and particularity. Apart from stating that meetings occurred on February 20-21, 1995 (Compl. ¶ 96) and May 2, 1995 (Compl. ¶ 132), plaintiffs have alleged no facts showing that a meeting took place wherein defendants received the requisite knowledge--i.e., what would later be reported on May 26, 1995--*apart from*

what was already disclosed on April 19, 1995.

Thus, I find that even considering the totality of the figures, facts, and statements, plaintiffs' synergistic argument must fail. In each area, plaintiffs have either failed to set forth facts with sufficient particularity to support their "failure to disclose" argument, or, as in the case of the allegedly actionable statements, they are simply not actionable standing alone. Here, the sum of the parts does not make plaintiffs' case whole. Reasonable inferences may be drawn in securities cases, but here the inferences are not sufficient to make out a cause of action.

B. <u>"Control Person" Liability under Section 20(a)</u>

Count II alleges a violation of Section 20(a) of the 1934 Act against the individual defendants. Section 20(a) provides that:

> Every person who, directly or indirectly, <u>controls any person liable under any provision of this title</u> or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a) (emphasis added).

The First Circuit has held that "in the securities context, control means 'the possession, direct or indirect, of the power to direct or to cause the direction of the management and policies of [an entity], whether through the ownership of voting

securities, by contract, or otherwise.'" Sheinkopf v. Stone, 927 F.2d 1259, 1270 (1st Cir. 1990) (citations omitted).

Here, because I find that Chipcom is not liable, the individual defendants cannot be held liable pursuant to § 20(a), and therefore the Complaint fails to state a "controlling person" claim.

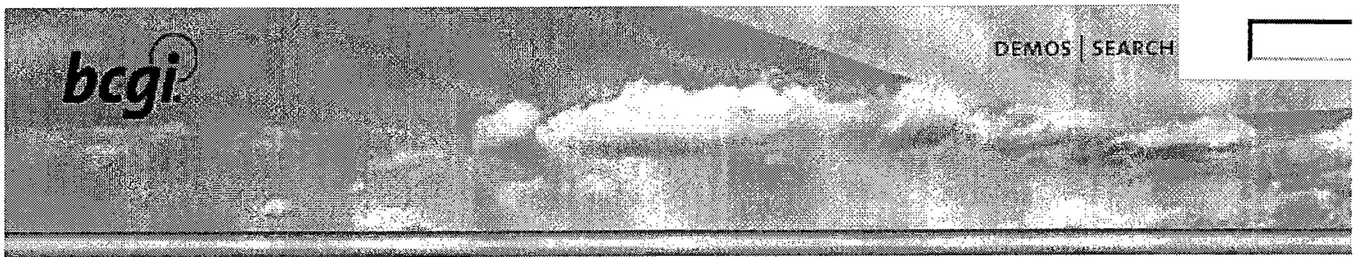
IV. Conclusion

For the reasons set forth more fully above, I hereby ALLOW defendants' motion to dismiss. The plaintiffs having been afforded sufficient opportunity to put their pleadings as well as they can, this grant of the motion to dismiss is without leave to amend.

Douglas P. Woodlock

DOUGLAS P. WOODLOCK
UNITED STATES DISTRICT JUDGE

EXHIBIT 6



bcgi ABOUT US

Press: Releases

Investor Alert

Boston Communications Group Announces First Quarter Financial Results

-- Pro forma earnings of $0.03 per share, ahead of initial guidance and in line w increased guidance issued on April 1st -- Company raises second quarter 2002 earnings estimates to $0.03 to $0.04 per share and reaffirms 2002 guidance -- Billed record number of minutes, resulting in average monthly minutes of use (MoUs) growing to 87, a 78% increase over the first quarter of 2001 -- Added 228,000 net new subscribers, bringing the total to 1.98 million at March 31, 20(-- Prepaid Wireless Services pro forma gross margin improved to 68% from 66' last quarter -- Repurchased 172,000 shares under Stock Repurchase Program

WOBURN, Mass., Apr 17, 2002 /PRNewswire-FirstCall via COMTEX/ -- Boston Communications Group, Inc. (Nasdaq: BCGI) today announced that, including non-recurring charges, its consolidated net loss for the first quarter ended March 31, 2002 w. $1.5 million or $(0.09) per share. Pro forma earnings (excluding an additional pre-tax charge of $3.3 million) for the first quarter ended March 31, 2002 were $466,000, or $0 per share, compared to pro forma earnings of $37,000 or $0.00 per share for the fourth quarter of 2001. Pro forma earnings are in line with expectations announced by the Company on April 1, 2002 and are slightly ahead of previously given guidance. Total revenues for the quarter were $15.0 million, compared to $14.3 million for the fourth quarter of 2001, reflecting growth of Prepaid Wireless Services revenues, partially offset lower revenues from the Company's Roaming Services businesses.

Pro forma results for the three months ended March 31, 2002 exclude an additional pre-charge of $3.3 million for legal expenses the Company expects it will incur to defend the patent infringement suit brought by Freedom Wireless. bcgi believes that the claims mac by Freedom Wireless are without merit and that the Company has meritorious defenses the action, and bcgi will continue to vigorously defend the action.

Prepaid Wireless Services

During the quarter, the Company billed a record number of prepaid minutes, resulting in average MoUs per subscriber increasing to 87 minutes per month, a 78% increase over 1 first quarter of 2001 and a 10% sequential increase. Higher usage was generated principally due to a continued influx of new, higher quality digital subscribers on carrier programs with more competitive pricing and features. The Company added 228,000 net subscribers during the quarter, a marked increase over the prior quarter and at the high end of guidance. The increase in MoUs and subscribers resulted in a 9% increase in prep revenues to $12.1 million compared to the previous quarter. Coupled with the Company' fixed cost business model and continued focus on managing its costs effectively, the increase in prepaid wireless services revenues resulted in pro forma gross margin improving to 68% compared to 66% for the fourth quarter ended December 31, 2001.

"As our results attest, bcgi's ability to leverage our unique real-time wireless subscriber management capabilities to develop a new standard for quality in prepaid wireless has created real value for our carrier customers, as it has enabled them to attract new subscribers and weather the competitive industry environment. Further, the well positioi and fiscally sound programs of our carrier customers provide us with a solid base from which to deliver profitable new growth opportunities for U.S. wireless carriers using our robust platform," commented E.Y. Snowden, President and CEO.

Continued Strong Financial Position

bcgi's balance sheet continues to remain strong with over $55 million in cash and short-term investments. The Company's cash balance decreased from $60.3 million at Decemt 31, 2001, principally due to the timing of capital expenditures that were deferred from tl fourth quarter 2001 to the first quarter 2002, the repurchase of the Company's stock for $1.5 million, and an increase in the Company's days sales outstanding.

Outlook

As announced in the Company's April 1, 2002 press release, bcgi reaffirmed its earnings estimates for the full year 2002 of between $0.19 and $0.23 per share. For the second quarter of 2002, the Company has raised it guidance and anticipates earnings of $0.03 t $0.04 per share. Commented E. Y. Snowden, "We are off to a solid start for 2002 and w are confident about the balance of the year. As a leader in real-time transaction processi solutions, we believe we are strongly positioned for future growth opportunities, particularly as the U.S. wireless industry continues to shift its focus for growth towards new segments. By serving as strategic partners with our carrier customers, we are able leverage our infrastructure to provide customers with high quality products that give the a competitive advantage in the marketplace."

The Company will be holding a conference call and Webcast at 5:00PM today to discuss this release. The Company's President and CEO, E.Y. Snowden, and Chief Financial Offic Karen A. Walker, will host the call. Parties interested in listening to the call should dial 1-800-423-5972 at least 10 minutes prior to the start of the call. The conference call and replay can also be accessed via the web at www.bcgi.net .

ABOUT THE COMPANY

Boston Communications Group, Inc., (Nasdaq: BCGI), bcgi, an S&P Small Cap 600 Inde company and Russell 2000 index company, is a leader in transaction processing solution for real-time wireless subscriber management, delivering prepaid wireless, mobile commerce and other billing and payment services. Founded in 1988, bcgi provides solutions to carriers through a combination of industry-leading proprietary software applications, a highly scalable transaction processing platform and its Intelligent Voice Services Network (IVSN). Through this nationwide real-time infrastructure, bcgi provide one or more of its services to approximately 70 wireless carriers and resellers, including four out of the six national carriers. bcgi's software, transaction processing platform and IVSN support bcgi's Prepaid Wireless service offering, a market leader in one of the high growth segments of the wireless communications industry. bcgi handles approximately 2 billion minutes of service a year. Please visit the bcgi web site at http://www.bcgi.net .

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This press release contains, in addition to historical information, forward-looking statements that involve risks and uncertainties, including statements regarding the Company's earnings estimates, ability to leverage its infrastructure and confidence abou future growth opportunities. Such statements are based on management's current expectations and are subject to a number of uncertainties and risks that could cause act results to differ materially from those described in the forward-looking statements. Amo the important factors that would cause actual results to differ materially from those indicated by such forward-looking statements are the number of new subscribers added the Company's prepaid service and the speed at which they are obtained, lower minutes use generated by subscribers, significant decreases or loss of business from major customers, declines in demand for the Company's Prepaid Wireless Services and Prepaid Connection services, the inability of the Company to successfully support its Intelligent Voice Services Network (IVSN) and transaction processing platform, unforeseen outages the Company's prepaid services, the inability of the Company's carrier customers to successfully market and sell prepaid service to subscribers, expenses to defend the Freedom Wireless suit in excess of the Company's estimate, an unfavorable judgment in the Freedom Wireless suit, general global economic conditions and the risk factors detail

in the Company's Form 10-K for the year ended December 31, 2001 filed with the Securities and Exchange Commission.

BOSTON COMMUNICATIONS GROUP, INC. AND SUBSIDIARIES
PRO FORMA (A) CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Pro Forma Three Months Ended 3/31/02	3/31/0
	(Unaudited)	
Revenues:		
Prepaid wireless services	$12,139	$14,02
Roaming services	1,583	3,34
Prepaid systems	2,447	2,42
Eliminations	(1,127)	(80
	15,042	18,98
Expenses:		
Cost of prepaid wireless services revenues	3,869	3,93
Cost of roaming services revenues	1,452	2,89
Cost of prepaid systems revenues	703	72
Engineering, research and development	1,973	2,27
Sales and marketing	1,129	1,44
General and administrative	1,418	1,71
	10,544	12,98
Income before depreciation, amortization, interest and taxes	4,498	6,00
Depreciation and amortization	4,128	3,86
Operating income	370	2,13
Interest income	411	75
Income before income taxes	781	2,89
Provision for income taxes	315	1,15
Net income	$466	$1,73
Diluted Income Per Share:		
Net income per common share	$ 0.03	$ 0.1
Shares used in computing net income per common share	17,486	17,69

Notes to Pro Forma Consolidated Statements of Operations:

(A) The above pro forma consolidated statements of operations exclude t effects of the following:

For the three months ended March 31, 2002, a one-time pre-tax charg of $3.3 million for legal expenses that represents the estimated fe the Company will incur to defend the patent infringement suit broug by Freedom Wireless.

BOSTON COMMUNICATIONS GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Three Months Ended 3/31/02	3/31/0
	(Unaudited)	
Revenues:		
Prepaid wireless services	$12,139	$14,02
Roaming services	1,583	3,34
Prepaid systems	2,447	2,42
Eliminations	(1,127)	(80
	15,042	18,98
Expenses:		
Cost of prepaid wireless services revenues	3,869	3,93
Cost of prepaid wireless services revenues - special charge	3,297	--
Cost of roaming services revenues	1,452	2,89
Cost of prepaid systems revenues	703	72
Engineering, research and development	1,973	2,27
Sales and marketing	1,129	1,44
General and administrative	1,418	1,71
	13,841	12,98
Income before depreciation, amortization, interest and taxes	1,201	6,00
Depreciation and amortization	4,128	3,86

Operating income (loss)	(2,927)	2,13(
Interest income	411	75(
Income (loss) before income taxes	(2,516)	2,89:
Provision (benefit) for income taxes	(1,006)	1,15(
Net income (loss) from continuing operations	$ (1,510)	$1,73(
Basic Income (Loss) Per Share:		
Net income (loss) per common share	$(0.09)	$ 0.1(
Shares used in computing net income (loss) per common share	17,157	17,01(
Diluted Income (Loss) Per Share:		
Net income (loss) per common share	$(0.09)	$ 0.1(
Shares used in computing net income (loss) per common share	17,157	17,69!

SEGMENT INFORMATION
($ in thousands and excluding special charges)

Quarter ended March 31,	Prepaid Wireless Services	Roaming Services	Prepaid Systems	Elim.	Tota:
2002					
Revenues	$12,139	$1,583	$2,447	$(1,127)	$15,04:
Gross margin	8,270	131	994	(377)	9,01(
Gross margin percentage	68%	8%	41%		60!
2001					
Revenues	$14,025	$3,341	$2,429	$(806)	$18,98!
Gross margin	10,091	447	1,213	(313)	11,43(
Gross margin percentage	72%	13%	50%		60!

CONSOLIDATED BALANCE SHEET DATA
(in thousands)

ASSETS	March 31, 2002 (Unaudited)	December : 2001
Current assets:		
Cash and short-term investments	$55,169	$60,25:
Accounts receivable, net of allowance for billing adjustments and doubtful accounts of $1,074 in 2002 and $1,169 in 2001	13,981	10,78:
Inventory	862	1,03(
Prepaid expenses and other assets	1,682	1,49(
Deferred income taxes	3,358	2,35:
Total current assets	75,052	75,91:
Property and equipment, net	39,877	38,79!
Goodwill and other assets	1,850	1,84!
Total assets	$116,779	$116,55:
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$19,154	$15,94:
Current maturities of capital lease obligations	427	74(
Total current liabilities	19,581	16,68:
Deferred income taxes	3,040	3,04(
Shareholders' equity:		
Common stock and additional paid-in capital	97,938	99,10(
Accumulated deficit	(3,780)	(2,27(
Total shareholders' equity	94,158	96,83(
Total liabilities and shareholders' equity	$116,779	$116,55:

SOURCE Boston Communications Group, Inc.

CONTACT: Investor Relations - bcgi, Dan Brosnan, +1-781-904-5410, dbrosnan@bcgi.n or General Inquiries, Amy Glynn, +1-212-445-8470, Media Inquiries, Judith Sylk-Siegel, +1-212-445-8431, or Investor Inquiries, Peter Seltzberg, +1-212-445-8457, all of FRB Weber Shandwick

EXHIBIT 7

FINAL TRANSCRIPT

Thomson StreetEvents℠

BCGI - Q1 2002 Boston Communications Group Earnings Conference Call

Event Date/Time: Apr. 17. 2002 / 5:00PM ET

FINAL TRANSCRIPT

CORPORATE PARTICIPANTS

E.Y. Snowden
Boston Communications Group - President and CEO

Karen Walker
Boston Communications Group - Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Peter felksburg (ph)

Carpenter Cato (ph)

Steve Levensen (ph)

Tim Clarion (ph)

Tavis McCourt (ph)

Howard Smith

Greg Probertenko (ph)

David Mantel (ph)

Omar Rosenbaum

PRESENTATION

Operator

Good afternoon. My name is Heather and I will be your conference facilitator today. At this time I would like to welcome everyone to the first quarter 2002 earnings conference for Boston Communications. All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question and answer period. If you would like to ask a question during this time simply press star and the number one on your telephone keypad and questions will be taken in the order they are received. If you would like to withdraw your question please press star and the number two. Thank you. I will now turn the call over to Mr. Peter Felksburg (ph). Thank you, sir. You may begin.

Peter felksburg

Good afternoon, everyone and thank you again for joining us today for Boston Communication Group's conference call to discuss 2002 first quarter results. By now you should have the release but if anyone still needs a copy please call Rob Hyman (ph) at 212 445-8469. That's at Financial Relations for Weber Shanwick (ph) or view and download at the Boston Communications Group corporate Web site www.bcgi.net. On the line today with us are E. Y. Snowden, President and CEO; and Karen Walker, Chief Financial Officer with Boston Communications Group. I'd also like to caution everyone that today's call discusses Boston Communications Group's business outlook and may contain forward-looking statements. Particular forward-looking statements and all other statements that may be made on this earnings conference call that are not historical facts are subject to a number of risks and uncertainties and actual results may differ materially. Please refer to the Safe Harbor Statement in today's press release and all filings with the SEC for more information on facts that could cause actual results to differ and now without further delay I'd like to turn the call over to E. Y. Snowden. Please go ahead, E. Y.

E.Y. Snowden - *Boston Communications Group - President and CEO*

Thanks, Peter, and again welcome to the Boston Communications Group first quarter conference call. We're very happy to be reporting on a strong quarter. Better yet we're happy to see the beginning of the favorable effects from the positive core trends we cited in our investment community conference calls at the end of last quarter. Carrier programs on our platform targeted at the attractive teen, young adult market segment continue to be strong attracting a much higher quality prepaid subscriber and generating a healthy proportion of the growth for the largest carriers in America. This quality of subscriber has engendered increasing support from the carriers evidenced by broader advertising campaigns, feature enhancements, more competitive pricing and promotion. This quality improvement is clear as we saw growth in our pre-paid minutes of use to new record levels with the average subscriber talking for 87 minutes a month this quarter, up 10 percent from last quarter and up nearly 80 percent from a year ago.

And it's not just one carrier driving this growth. As we said in our April 1 press release the average MRUs per month per subscriber increased for every one of our major carriers this quarter. It's particularly nice to be talking about these good results during relatively tough times for the industry. In fact, it's not so much that we did well in spite of the tougher environment as it is that we did well because of the challenges that are driving carriers to seek new avenues for growth. We've laid the solid foundation for success in one of the highest growth segments of wireless. We've executed well on a plan for proving in the attractiveness of the prepaid wireless business. We've demonstrated the superior functionality, flexibility and end-to-end economics of BCGI's

so it just seemed kind of-- I expected that number to go down a little bit.

E.Y. Snowden - *Boston Communications Group - President and CEO*

Did you do a function of the valuation and formulas used on options or something--? I believe it's the price of the stock that drives the recognition of shares to be counted in that formula out of shares that are options outstanding or other assets and I apologize. I'm not an expert but as the price of the stock actually dropped, the corresponding divisible number of shares into a fully diluted formula shrank as well.

Greg Probertenko

Okay so it's like a treasury stock method thing or something?

Karen Walker - *Boston Communications Group - Chief Financial Officer*

What number are you showing? I'm trying to figure out what number you're comparing it to, Greg.

Greg Probertenko

At the end of fourth quarter I saw 17,182 and now this quarter I've been seeing 17,486.

Karen Walker - *Boston Communications Group - Chief Financial Officer*

Yeah, which is principally just due to the pricing of the shares.

Greg Probertenko

Okay, then I'll leave it at that. Thanks.

Operator

There are no further questions at this time. Do you have any closing remarks?

E.Y. Snowden - *Boston Communications Group - President and CEO*

Yes, we do. Thank you all for joining us today. As you can hear we are energized over the exciting role we've carved out for ourselves in enabling the largest carriers in America that use our platform to position prepaid products as mainstays of their business relying upon us for the new growth opportunities they seek. The success that our customers are having with these new products and the developments that we have underway for new capabilities, services and customer relationships gives us confidence in the future ahead for BCGI. We look forward to sharing our success and executing on this plan with you. Thank you for your time.

Operator

This concludes this afternoon's teleconference. You may now disconnect.

EXHIBIT 8

Boston Communications Group Daily Stock Price

Date	Open	High	Low	Close	Volume
18-Aug-04	8.3	8.87	8.3	8.69	138,900
17-Aug-04	8.25	8.58	8.25	8.38	115,800
16-Aug-04	7.91	8.3	7.85	8.25	130,500
13-Aug-04	7.72	7.9	7.72	7.87	315,100
12-Aug-04	7.85	8.12	7.78	7.78	128,600
11-Aug-04	8.17	8.24	7.87	8.1	231,900
10-Aug-04	8.3	8.31	8.1	8.23	135,500
9-Aug-04	8.25	8.46	8.18	8.28	279,200

EXHIBIT 9
(1 of 2)

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

IN RE CYTYC CORP. SECURITIES LITIGATION	CIVIL ACTION NO. 02-12399-NMG

REPORT AND RECOMMENDATION RE:
DEFENDANTS' MOTION TO DISMISS THE CORRECTED CONSOLIDATED AMENDED CLASS ACTION COMPLAINT
(DOCKET ENTRY # 30)

March 1, 2005

BOWLER, U.S.M.J.

Pending before this court is a motion to dismiss (Docket Entry # 30) filed in this consolidated class action by defendants Cytyc Corporation ("Cytyc"), Patrick Sullivan ("Sullivan"), Cytyc's President and Chief Executive Officer throughout the class period,[1] and Robert Bowen ("Bowen"), Cytyc's Chief Financial Officer and Vice President throughout the class period. After conducting a hearing, this court took the motion (Docket Entry # 30) under advisement.

PROCEDURAL BACKGROUND

The gravamen of the corrected amended complaint (henceforth: "the complaint") (Docket Entry # 27) filed by lead plaintiffs Plumbers and Pipefitters National Pension Fund and Deka Investment GMBH ("plaintiffs") is that Sullivan and Bowen ("the individual defendants") and Cytyc, a company that produces and manufactures medical devices that screen for cervical and breast

[1] Sullivan also took on the role of Chairman of the Board of Directors on November 20, 2001, a role he maintained throughout the remainder of the class period.

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cancers, engaged in channel stuffing throughout the class period (July 25, 2001 to June 25, 2002). Channel stuffing is the practice of "inducing purchasers to increase substantially their purchases before they would, in the normal course, otherwise purchase products from the company." Greebel v. FP Software, Inc., 194 F.3d 185, 202 (1st Cir. 1999). It has "the result of shifting earnings into earlier quarters, quite likely to the detriment of earnings in later quarters." Greebel v. FP Software, Inc., 194 F.3d at 202.

The channel stuffing, which purportedly occurred at the end of each quarter, concerned Cytyc's principal product, the ThinPrep system ("ThinPrep"). ThinPrep competes with the more traditional Pap smear test as a means of screening women for cervical cancer.

Plaintiffs submit that the individual defendants and Cytyc (collectively: "defendants") failed to disclose or only partially disclosed the channel stuffing during the class period. Statements made by Sullivan, various third parties or contained in the company's SEC filings were false or materially misleading regarding the deep discounts that Cytyc offered customers near the end of every quarter. As a result, reported revenues, earnings and market share were artificially inflated. Defendants thereby mislead investors about earnings and the reasons for the company's growth and increased sales. In addition, defendants violated the company's internal revenue recognition policy, SEC regulations and generally acceptable accounting principles

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("GAAP") by shipping unordered product to customers and engaging in channel stuffing.

The two count, 62 page complaint, which includes 187 paragraphs, alleges violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R. § 240.10b-5. Defendants move to dismiss the complaint under Rule 12(b)(6), Fed. R. Civ. P. ("Rule 12(b)(6)"), for failing to plead fraud with particularity under Rule 9(b), Fed. R. Civ. P. ("Rule 9(b)"), and the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u-4. Defendants additionally seek dismissal on the basis that the statements are inactionable corporate puffery, neither false or misleading, not material and lack the necessary strong inference of scienter. Defendants also rely on the safe harbor provision of the PSLRA pertaining to forward looking statements. See 15 U.S.C. § 78u-5(c)(1)(A)(i); 17 C.F.R. § 240.3b-6.

STANDARD OF REVIEW

In reviewing the motion to dismiss, this court accepts the factual allegations in the complaint as true and draws all reasonable inferences in favor of plaintiffs. See Alternative Energy v. St. Paul Fire & Marine, 267 F.3d 30, 33 (1st Cir. 2001) (on motion to dismiss, court accepts all allegations in complaint as true and construes "all reasonable inferences in favor of the plaintiffs"). Without crediting unsubstantiated conclusions, Rodi v. Southern New England School of Law, 389 F.3d 5, 10 (1st

Cir. 2004) (ignoring "'bald assertions, periphrastic circumlocutions, unsubstantiated conclusions, [and] outright vituperation'"), dismissal is appropriate "only if it 'appears to a certainty that the plaintiff would be unable to recover under any set of facts.'" State Street Bank and Trust Company v. Denman Tire Corporation, 240 F.3d 83, 87 (1st Cir. 2001); accord Blackstone Realty LLC v. FDIC, 244 F.3d 193, 197 (1st Cir. 2001) (dismissal proper "only if, under the facts alleged," plaintiffs "cannot recover on any viable theory;" internal quotation marks omitted).

The pleading standards under the PSLRA do not alter this standard of review. Aldridge v. A.T. Cross Corporation, 284 F.3d 72, 78 (1st Cir. 2002). Facts, drawn primarily from the complaint as well as certain public and integral documents referred to in the complaint,[2] are as follows.

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[2] In Re Stone & Webster, 253 F.Supp.2d 102, 128 & n. 11 (D.Mass. 2003) (considering copies of SEC Forms 4 without converting motion to dismiss into motion for summary judgment); In Re Millstone Scientific Securities Litigation, 103 F.Supp.2d 425, 450-451 & n. 15 (D.N.J. 2000); see Alternative Energy v. St. Paul Fire and Marine, 267 F.3d 30, 33-34 (1st Cir. 2001); Blackstone Realty, LLC v. FDIC, 244 F.3d at 195 n. 1 (exhibits attached to complaint properly considered for purposes of Rule 12(b)(6)); Shaw v. Digital Equipment Corporation, 82 F.3d 1194, 1206 n. 13 & 1220 (1st Cir. 1996) (inasmuch as complaint alleged nondisclosure in registration statement and prospectus, court may examine text of filings and any incorporated SEC filings); Watterson v. Page, 987 F.2d 1, 3 (1st Cir. 1993); In Re Parametric Technology Corporation Securities Litigation, 300 F.Supp.2d 206, 213 n. 7 (D.Mass. 2001) (considering "full text of the Form 10-Q," including "parts not relied on by the plaintiffs," on a motion to dismiss inasmuch as complaint refers to the document); see also Clorox Company Puerto Rico v. Proctor & Gamble, 228 F.3d 24, 32 (1st Cir. 2000) ("'when a written instrument contradicts allegations in the complaint to which it is attached, the exhibit trumps the allegations'").

BACKGROUND

Cytyc develops, manufactures and markets the sample preparation system known as ThinPrep. ThinPrep is an automated system for preparing cervical cell specimens on microscope slides. In May 1996, Cytyc received premarket approval from the Food and Drug Administration ("FDA") to market ThinPrep as a screening system for cervical cancer. The product directly competes with the conventional Pap smear test. In November 1996, the FDA allowed Cytyc to label and market ThinPrep as "significantly more effective in detecting cervical cancer than the Pap smear." (¶ 34).[3]

The company, which has a plant in Boxborough, Massachusetts, began selling ThinPrep nationwide in 1997. It is the company's chief or principal product. In September 1997, the FDA gave Cytyc premarket approval to use specimen collected in ThinPrep solution to test for the presence of the human papillomavirus. The company markets ThinPrep to healthcare providers, insurance companies and clinical laboratories. In 1998, it began marketing ThinPrep selectively overseas in international markets.

Net sales for the year ending in December 2000 reached $142,337,000 before the start of the class period. Cytyc's reported share of the cervical testing market prior to the class period ranged from 50% to 60%.

[3] Unless otherwise noted, citations to paragraphs only refer to paragraphs in the complaint, Docket Entry Number 27.

A. Customer Complaints, Discounts and Unordered Products

According to an unnamed, former medical and sales representative ("Cytyc sales representative"), "Beginning in at least 1999, . . . Cytyc 'typically engaged in channel stuffing at the end of each quarter.'" (¶ 38). This sales representative dealt directly with physicians concerning ThinPrep and describes, in general terms, that "Cytyc overloaded laboratories with inventory" in order to drive up profitability and sales. (¶ 38). With slightly greater specifically, he or she identifies Onco, located in Gaithersburg, Maryland as "a frequent victim of Cytyc's channel stuffing."[4] (¶ 47). Also according to this sales representative, certain unidentified "Cytyc account executives" told him or her that "Cytyc occasionally sent merchandise to laboratories, despite requests from those customers to refrain from shipping any more product." (¶ 49).

An unnamed former managed care executive ("Cytyc managed care executive") who dealt directly with laboratories and physicians states that, Cytyc offered special discounts to customers "towards the end of each quarter." (¶ 50). He or she does not identify the customer, the amount of the discount or the relationship of the amount shipped to Cytyc's revenues. Instead, the managed care executive posits that if a customer, again unidentified, "needed only one thousand tests a month, the customer still knew that if it took three thousand tests in the

[4] The representative does not provide any additional detail such as the amount of product stuffed and the dates of the shipments.

last month of a quarter, Cytyc would offer a much bigger discount." (¶ 50).

Another unnamed, former regional sales manager who became a senior representative ("Cytyc senior representative") and dealt directly with customers in six western states describes that, "from at least July 1999, Cytyc shipped additional product to its customers, above what had been ordered" until the customer complained that it had too much inventory.[5] (¶ 44). Labcorp was one of the Cytyc customers that complained to the Cytyc senior representative about the company's sales practices.[6] (¶ 49).

A former Cytyc account executive who covered the northwest region ("Cytyc NW account executive") and had direct customer contact relates that customers complained about storing the excess product on "pallets in their hallways."[7] (¶ 43). Likewise, an unnamed, former Cytyc electrotechnical technician ("Cytyc technician") relates, again at an undetermined time and in an undetermined amount, seeing "stockpiles of inventory lying unused" when he visited customers in the New England region to fix technical problems. (¶ 51).

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[5] The complaint does not identify when these shipments occurred, the amount and the amount's relation to Cytyc's overall business. There is no indication that the shipments were returned.

[6] The complaint does not attribute this assertion to a particular individual. The source of the statement is thus unknown. There is also no indication when the complaint[s] occurred or the amount of the shipment[s] involved.

[7] Again, no detail is provided regarding the identity of the customers and when and how much pallet storing occurred.

Another former, unnamed Cytyc account executive for California ("Cytyc CA account executive") notes that in December 2000, Cytyc shipped the Palo Alto Medical Foundation ("Palo Alto Medical") "a year's worth of product without having received an order to do so."[8] (¶ 45). There is no indication that Palo Alto returned the shipment. It was, however, given a 50% discount, which exceeded the typical 20% end of quarter discount.[9]

The Cytyc CA account executive also identifies Stockton Pathology, located in Stockton, California, as receiving "six months' worth of product," albeit at an unidentified time. Although not returned,[10] the excess product "lay unused, piled floor-to-ceiling in the customer's offices." (¶ 45). At an undetermined time, "Stanford University Hospital and Marin Pathology cancelled their agreements with Cytyc because they were fed up with being shipped unwanted merchandise," according to this executive. (¶ 157).

"Management" encouraged channel stuffing to meet unrealistic quarterly quotas, according to the Cytyc CA account executive. (¶¶ 46 & 47). Channel stuffing occurred at the end of every quarter, according to both this executive and the Cytyc managed

[8] A "year's worth" of ThinPrep would, of course, extend into the class period which began in June 2001.

[9] The complaint fails to articulate the amount of the shipped product discounted and/or the relation to Cytyc's overall revenues.

[10] Although not expressly stated in the complaint, this is the only reasonable inference inasmuch as the complaint depicts how the excess product lay unused at the customer's offices.

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care executive (¶¶ 111 & 123) and was well known in the company (¶ 150). During the last quarter of 2001, the company increased its channel stuffing practices by offering "extra incentives" to customers and created a "'war room'" to field the daily telephone calls from sales representatives giving updates of sales figures, according to an unnamed human resources representative at Cytyc who describes Sullivan and Bowen as "very involved" in daily management.[11] (¶¶ 40 & 101). As a result of the channel stuffing, the market share described to analysts by Sullivan and other management officials was allegedly overstated. (¶ 47).

Cytyc disclosed the use of discounts in the December 2000 Form 10-K annual report, signed by Sullivan and Bowen, in the following terms:

> The Company's success and growth will depend on market acceptance of the ThinPrep System among healthcare providers, third-party payors and clinical laboratories. The Company will continue to sell the ThinPrep Processor to customers and charge separately for related disposable reagent filters and supplies. *In the past, the Company has offered discounts to stimulate demand for the ThinPrep System and may elect to do so in the future, which discounts could have a material adverse effect on the Company's business, financial condition and results of operations.*

(Docket Entry # 32, Ex. B, p. 8; emphasis supplied). Cytyc repeated this disclosure in the company's 2001 Form 10-K annual

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[11] The company was highly focused on meeting the sales quotas which were "set by Cytyc's management" (¶ 153) and, according to an unnamed manufacturing manager ("Cytyc manufacturing manager"), top executives met frequently with employees "to discuss sales strategies." (¶ 39). Cytyc senior management also closely managed the everyday business of Cytyc and attended meetings with the salesforce. (¶¶ 41 & 150).

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report.[12] (Docket Entry # 32, Ex. J, pp. 8-9).

Cytyc also shipped "significant" amounts of "additional product" above and beyond what customers ordered. (¶ 61). As noted above, Cytyc's senior representative describes shipments of unknown quantities of ThinPrep to unknown customers "from at least July 1999." (¶ 44). At Cytyc, shipping more product than ordered to increase sales occurred near the end of the financial reporting periods. (¶¶ 5 & 7; see also ¶ 49).

B. Specific Company Statements During Class Period

1. July 25, 2001 Press Release

At the outset of the class period on July 25, 2001, Cytyc's stock was trading for $24.79. (¶ 9). On that day, Cytyc issued a press release reporting "record" revenue and earnings for the second quarter of 2001. (Docket Entry # 32, Ex. A). The release accurately reported $52,997,000 of revenue for the quarter or net income of $.13 per diluted share.[13] (¶ 67; Docket Entry # 32, Ex. D, p. 4; Docket Entry # 32, Ex. J, p. F-22).

Plaintiffs take issue with the following statements, the first historical and the others forward looking, made by Sullivan

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[12] Like the 2000 Form 10-K annual report, the 2001 Form 10-K annual report discloses that, "In the past, the Company has offered discounts to stimulate demand for the ThinPrep System and may elect to do so in the future, which discounts could have a material adverse effect on the Company's business, financial condition and results of operations." (Docket Entry # 32, Ex. J, pp. 8-9).

[13] There is no indication that these numbers were subsequently restated. (Docket Entry # 32, Ex. J, p. F-22).

in the press release:[14]

> "We are pleased to report record revenues and earnings," said Patrick Sullivan, Cytyc's president and chief executive officer. "In addition, we increased our U.S. market share by five percentage points for the second consecutive quarter. Our U.S. market share has grown substantially to approximately 46 percent at June 30 from 36 percent at the end of 2000, and we expect to exceed 50 percent domestic market conversion by year-end. *This growth has been driven by the combination of our proven marketing strategy, best-in-class sales team, and superior technology.*"
>
> In conclusion, Mr. Sullivan stated, "As Cytyc continues to achieve record results in the marketplace, I am confident in our ability to *continue the momentum established in the first half of the year*. We look forward to *continuing our consistent quarter to quarter growth* and *delivering a record financial performance* for 2001."

(¶¶ 67 & 69-70; emphasis in complaint). Defendants purportedly knew that the stated reasons ("proven marketing strategy, best-in-class sales team, and superior technology") were not the real reasons for the historical growth. Instead, the real reasons were the channel stuffing of products at the end of every quarter and the shipments of unordered product. Cytyc then improperly recognized the revenue on these products at the expense of future sales and in contravention of the company's stated revenue recognition policy, GAAP and SEC rules. (¶ 68).

With respect to the forward looking statements, plaintiffs submit that defendants knew that the "momentum" and "consistent quarter to quarter growth" were the result of channel stuffing, including the steep, end-of-quarter discounts, and that the momentum could not continue without continuing the channel

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[14] The press release was relatively short, consisting of two pages of text and two pages of a company balance sheet.

stuffing practices. (¶¶ 69-70). It is worth noting, however, that the relatively short press release contains the following cautionary language:

> Investors are cautioned that statements in this press release which are not strictly historical statements, including, without limitation, statements regarding management's expectations for future growth, profitability, and objectives for future management and operations, as well as statements regarding the management and operations . . . constitute forward-looking statements which involve risks and uncertainties which could cause actual results to differ, including, without limitation, risks associated with the Company's dependence on a single product, uncertainty of market acceptance and additional cost, dependence on proprietary technology, dependence on timely and adequate levels of third-party reimbursement, dependence on key personnel, management of growth, limited marketing, sales, and private equity investment experience, and limited number of customers and lengthy sales cycle . . . and other risks detailed in the Company's filings with the Securities and Exchange Commission, including under the heading "Certain Factors Which May Affect Future Results" in its 2000 Form 10-K filed with the Commission.

(Docket Entry # 32, Ex. A). The language in the Form 10-K under the referenced caption provides added detail about the above risk factors. Regarding the "Limited Marketing and Sales Experience" factor, the Form 10-K warns that:

> No assurance can be given that the Company's direct sales force or strategic marketing relationships will succeed in promoting the ThinPrep System to healthcare providers, third-party payors or clinical laboratories, or that additional marketing and sales channels will be successfully established . . . Failure to successfully expand its marketing and sales capabilities in the United States . . . would have a material adverse effect on the Company's business, financial condition and results of operations.

(Docket Entry # 32, Ex. B). With respect to the "Limited Number of Customers and Lengthy Sales Process" factor, the Form 10-K explicitly states that, "Due in part to a recent trend toward consolidation of clinical laboratories, the Company expects that

the number of potential domestic customers for its products will decrease." (Docket Entry # 32, Ex. B).

The press release notes that management would discuss the results and future expectations at a 5:00 p.m. conference call later that day. After the conference call, accessed by the public through the company's website, analysts projected the company's market share as soon reaching 50%. (¶ 72).

2. Bloomberg News Interview August 2, 2001

On August 2, 2001, Bloomberg News interviewed Sullivan and published a transcript of the interview. Whereas on July 25, 2001, Sullivan attributed past growth as driven by the company's "proven market strategy" and "sales team," he forecasted that similar factors of the company's "unique sales and marketing strategy" would allow the company to increase its market share in the future. (¶ 73). Referring to the July 25, 2001 conference call, he projected annual revenues in 2001 as between $210,000,000 and $220,000,000 and between $275,000,000 and $300,000,000 for the following year.

The text of the interview reads, in pertinent part, as follows:[15]

> [Bloomberg News]: Mr. Sullivan, taking a look at your revenue numbers, this past quarter, they grew at 12% sequentially and they were up about 60% from a year ago. *Can you maintain that kind of growth in terms of revenue?*
>
> Sullivan: *We believe so.* If you look at the market opportunity. We believe we're getting started and hitting our stride. In the sweet spot of the curve. If you look at the 50 million Pap smears, it represents for us about a $500

[15] Punctuation is taken from the transcript.

million to $700 million market opportunity.

> [Bloomberg News]: *Well, how will you increase, though market share and be aggressive in gaining market share [in] this?*
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> Sullivan: *We have a unique sales and marketing strategy in that we have a direct sales force that calls on the OB/GYN's who perform the procedure in their office. In addition we have a sales force calling on the laboratory. It is creating the demand at the physician's office.* And we have also started some direct consumer advertising campaigns . . .
>
> [Bloomberg News]: *Give investors some sort of landmarks that they should sort of watch out for or milestones, if you will that they should watch for from your company over the next six to eight months to see that you're certainly on track in terms of exceeding or meeting your growth goals?*
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> Sullivan: Well, *we've guided the street in our conference call* that we believe we're going to finish this year somewhere between $210 million and $220 million in top line revenue, [we] believe that we will be at the top end of that range. Next year we expect to be in the $275 million to $300 million range. In addition we have these additional products that we're currently working on that we expect to have completed by the end of this year.[16]

(¶¶ 73 & 75, emphasis in complaint; Docket Entry # 32, Ex. C).

3. <u>August 8, 2001 Second Quarter Form 10-Q</u>

On August 8, 2001, Cytyc issued the Form 10-Q for the quarter ending June 30, 2001. All defendants, including Bowen, signed the form. The form reflects the following method for recognizing revenue:

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[16] Like the July 25, 2001 statements, defendants submit that the statements are corporate puffery and do not denote marketing strategy and the sales force as the only factors effecting growth. They also maintain that the projections, which reference the conference call, were not material inasmuch as they did not alter the total mix of information available to the investing public. Plaintiffs characterize Sullivan's stated reasons as false and materially misleading inasmuch as channel stuffing was and would continue to have an adverse impact on future sales.

> The Company recognizes product revenue upon shipment, provided that there is persuasive evidence of an arrangement, there are no uncertainties regarding acceptance, the sales price is fixed or determinable, collection of the resulting receivable is probable and only perfunctory Company obligations included in the arrangement remain to be completed.

(¶¶ 58 & 78; accord Docket Entry # 32, Ex. B & J, pp. F-7). Cytyc therefore recognized revenue upon shipment.[17]

This second quarter Form 10-Q for 2001 portrays net sales of $100,464,000, an increase from the $62,303,000 reported during the corresponding period in 2000. The Form 10-Q advises that certain factors may affect future results, refers to additional factors disclosed in the Form 10-K for 2000 and cautions that, "past financial performance should not be considered an indiction of future performance." (Docket Entry # 32, Ex. D, p. 13).

In describing the company's liquidity and capital resources, the form notes that, "Net inventories decreased approximately $1.3 million during the six months ended June 30, 2001 primarily due to improved inventory management and production control." (¶ 81; Docket Entry # 32, Ex. D, p. 11). The release of the August 8, 2001 Form 10-Q caused a one day increase in the price of Cytyc stock from $24.20 to $25.90.

4. October 19, 2001 Boston Herald Article

On October 18, 2001, Cytyc announced that it would acquire Pro-Duct Health, Inc. ("Pro-Duct"), a private company that makes

[17] As explained in greater length infra, plaintiffs allege that Cytyc departed from this stated policy by recognizing the revenue upon shipping the unordered product and by offering the deep discounts offered customers at the end of every quarter or otherwise engaging in channel stuffing. (¶ 79).

a breast cancer screening device, for $38,000,000 in cash and 5,000,000 shares of Cytyc common stock. Sullivan described the acquisition as an "ideal fit" with "an annual potential U.S. market of $1.5 billion, growing to $4.0 billion." (¶ 84). The acquisition was scheduled to close and did close in the fourth quarter of 2001. Cytyc's stock increased from $25.79 on October 17 to $26.55 on October 18, 2001. (¶ 84; Docket Entry # 32, Ex. E).

On October 19, 2001, the Boston Herald ran an article quoting Sullivan as saying, "'*We feel confident in our success based on our track record with the ThinPrep Pap Smear, which has made this acquisition possible.*'"[18] (¶ 87, emphasis in complaint; Docket Entry # 32, Ex. E). Cytyc stock closed at $28.03 on October 19, 2001. (¶ 86).

5. <u>October 24, 2001 Press Release</u>

On October 24, 2001, Cytyc issued a press release reporting record revenues for the third quarter of 2001. Third quarter revenue "was $57.2 million, . . . a 54 percent increase from the $37 million reported in the comparable quarter last year."[19] (¶

[18] Plaintiffs describe the statement as misleading because it omits the fact that Cytyc's "track record" is based upon undisclosed channel stuffing. Plaintiffs also point out that Cytyc's stock would have been worthless and the acquisition therefore costlier if the company had not artificially inflated the company's stock through channel stuffing. (Docket Entry # 36). Defendants, in turn, assert that the statement amounts to inactionable corporate puffery and there is no connection between the statement, i.e., the efficacy of ThinPrep, and the omitted information of channel stuffing.

[19] The Form 10-K for 2001, released in March 2002, reflects these same figures. (Docket Entry # 32, Ex. J, p. F-22).

89; Docket Entry # 32, Ex. F). Sullivan glowingly described the Pro-Duct acquisition as "'provid[ing] an excellent opportunity for significant revenue and earnings growth.'" (¶ 89; Docket Entry # 32, Ex. F).

Plaintiffs take issue with Sullivan's historical description of the company's consistent revenue growth as emanating from "'*the effectiveness of [Cytyc's] sales and marketing strategy.*'"[20] (¶ 89, emphasis in complaint; Docket Entry # 32, Ex. F). According to the complaint, the statement is misleading because the reported growth arose from the "systemic and continuous channel stuffing" as well as shipping unordered products to customers, a practice that alienated such customers and caused them to cease doing business with Cytyc. (¶ 90). Further, Cytyc did not experience "consistent revenue and earnings growth" because the Cytyc sales and marketing strategy of channel stuffing pushed sales into earlier quarters at the expense of later periods. (¶ 91).

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[20] The complete statement in the press release is as follows:

> "We believe the superior clinical performance of the ThinPrep Pap Test and *the effectiveness of our sales and marketing strategy have provided Cytyc with consistent revenue and earnings growth and financial performance*," said Patrick Sullivan, Cytyc's president and chief executive officer. "Last week we announced that Cytyc has entered into a definitive merger agreement to acquire Pro-Duct Health, Inc., an acquisition that we expect will expand our product line to include breast cancer and provide an excellent opportunity for significant revenue and earnings growth."

(¶ 89, emphasis in complaint; Docket Entry # 32, Ex. F).

6. January 14, 2002 Press Release

On January 14, 2002, Cytyc issued a press release reiterating the company's comfort level with the estimate of "approximately $0.13 per diluted share" for the 2001 fourth quarter and "approximately $0.45 per diluted share" for the full year. (¶ 95; Docket Entry # 32, Ex. G). Cytyc also forecasted 2002 per share earnings as "approximately $0.64 to $0.66." (¶ 95; Docket Entry # 32, Ex. G). The latter forecast did not materialize.

Like the July 25, 2001 press release, the January 14, 2002 press release cautions investors not to rely on the forecasts and that current expectations "are subject to risks and uncertainties which could cause the outcomes to differ materially from [the forward-looking] statements." (Docket Entry # 32, Ex. G). The press release identifies various risk factors and refers investors to the company's SEC filings.

The complaint depicts the falsity of the statements insofar as the revenue numbers, inflated because of the company's channel stuffing practices, contravene the company's stated revenue recognition policy as well as GAAP and SEC rules. (¶ 100).

7. January 23, 2002 Press Release

On January 23, 2002, Cytyc announced "record" revenues for the 2001 fourth quarter and for the year. The press release shows revenues "of $63 million for the quarter" representing a "49% increase over the fourth quarter 2000 revenues, and" net income of $0.13 per share. (¶ 96). Revenues grew to $221

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million for the year. (¶ 96). As set forth in the complaint, these earnings include ThinPrep sales resulting from the channel stuffing and shipments of unordered product thereby violating the company's stated revenue recognition policy, GAAP and SEC rules. (¶ 100).

The complaint highlights and complains about two statements, the first being historical and the second forward looking, that Sullivan made in the press release. The statements, italicized below, are as follows:

> "This was an outstanding year for Cytyc Corporation," said Patrick Sullivan, Cytyc's president and chief executive officer. "*We have now reported fifteen consecutive quarters of revenue growth.* In addition, we acquired Pro-Duct Health, expanding our product line to include breast cancer risk assessment." Mr. Sullivan continued, "We believe the success of the company was further demonstrated by Cytyc's recent addition to the S & P Midcap 400 Index and The Nasdaq-100 Index." Mr. Sullivan concluded, "*We believe the achievements of 2001 put Cytyc in a solid position to build on the momentum of the past year* and the success of ThinPrep(R) System, to continue domestic and international market conversion to the ThinPrep(R) PapTest(TM), and to launch Cytyc's ductal lavage procedure for patients at high risk for breast cancer."

(¶ 96, emphasis in complaint).

As the complaint alleges, plaintiffs submit that the first statement is misleading and false because Cytyc achieved the historical growth by resort to undisclosed channel stuffing.[21] (¶ 100). Again, the reported growth improperly includes sales from the channel stuffing at the end of each quarter and the shipments of unordered products. (¶ 100). In light of this

[21] Plaintiffs do not take issue with the veracity of the numbers as reflecting what Cytyc achieved. (Docket Entry # 36).

improper revenue recognition, the assertion that Cytyc was "'in a solid position'" to build upon previous "'momentum'" was false and misleading. (¶ 100). The press release contains cautionary statements similar to those in previous press releases.

8. Bloomberg News Interview January 24, 2002

The day after the January 23, 2002 press release, Bloomberg News interviewed Sullivan about the reported fourth quarter profits. Without referring to the January 23, 2002 press release or the cautionary statements therein, Sullivan forecasted revenues "'in the $295 to $305 million range'" and an increase in earnings per share to "'between 64 and 66 cents.'"[22] (¶ 99).

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[22] Defendants submit that the complaint fails to identify which remarks in the interview are false. To the contrary, however, paragraph 99 not only quotes the above forecast but also repeats the forecast by stating that, "Sullivan raised Cytyc's expected revenues for 2002 to between $295 million-$305 million, up from the $275 million-$300 million range originally given on August 2, 2001." (¶ 99). The next paragraph alleges that, "Defendants knew that the statements in paragraphs 95-97, 99, were false." (¶ 100). Defendants' additional challenge that the forecast is inactionable puffery (Docket Entry # 39, n. 3, referring to "the January 24, 2002 press release [sic]") is unavailing given the explicit nature of the forecast. The statement, to the extent based on a current projection, provides the revenue range and expected earnings per share for the time frame of one year.

As explained infra with respect to the August 2, 2001 projection and argued in general by defendants in their memorandum (Docket Entry # 31, p. 39) and at the hearing, however, the complaint fails to show sufficient facts to support the information and belief that Sullivan knew the forecast was either false or materially misleading. Neither the opinion by the former human resources employee (¶ 154) nor his or her characterization of Sullivan and Bowen as "'hands-on'" managers (¶ 40) is enough. As to materiality, disclosing the use of discounts as effecting the projection would not alter the total mix of information inasmuch as the SEC filings already disclosed such discounts. Alternatively, the projection fails to warrant liability given the absence of a strong inference of scienter.

Shortly after this forecast, the following exchange took place:

> [Bloomberg News]: *What keeps growth moving forward?*
>
> Sullivan: *Well, we're very focused on continued conversion of the ThinPrep Pap Test in the market, from 57 percent to-we believe we could capture-100 percent of the market.*[23] There's no reason for a physician to use a conventionally prepared Pap smear, when you have a much more effective test that's in the ThinPrep PapTest . . . In addition, we have acquired a company that puts us into breast cancer screening called Product Health [sic], that we have just launched with our sales force at the beginning of this year. And we expect somewhere between $9 and $15 million of revenue from that product, to kick in 2002.

(¶ 99, emphasis in complaint; Docket Entry # 32, Ex. I). Two market analysts repeated Sullivan's statement that the company's current market share was 57%. (¶ 102).

In February 2002, Cytyc announced a definitive merger agreement to acquire Digene Corporation ("Digene"), a publicly held manufacturer of a cervical cancer diagnostic screening system. Subject to regulatory approval and a tender of over 50% of Digene stock, the deal proposed Cytyc purchasing Digene "for $76.9 million in cash, plus 23 million shares of Cytyc common stock."[24] (¶ 103). Shortly after the announcement, Cytyc shares

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[23] Defendants characterize this statement as inactionable puffery. Although the statement that Cytyc could capture 100% of the market is corporate puffery, the statement that Cytyc had 57% of the market is not puffery. The statement quantifies market share and two analysts repeated the statement. (¶ 102); see In Re Scientific Atlanta, 239 F.Supp.2d 1351, 1361 n. 6 (N.D.Ga. 2002). The 57% market share statement is nonetheless not actionable given the absence of a strong inference of scienter. See n. 65.

[24] The 2001 Form 10-K released in March 2002 warns investors that, "Although [Cytyc] expects that its acquisition of Digene will close during the second quarter of 2002, [Cytyc] may

increased by $2.00. (¶ 104). Although Digene shareholders tendered more than 50% of outstanding Digene shares, the Federal Trade Commission ("FTC") eventually voted to block the acquisition on June 25, 2002.

On March 1, 2002, Cytyc filed the company's 2001 Form 10-K with the SEC. The form repeats the statement in the 2000 Form 10-K that Cytyc has offered discounts in the past to stimulate demand "and *may elect* to do so in the future" and that such discounts "*could have* a material adverse effect on the Company's business, financial condition and results of operations."[25] (¶ 110, emphasis in complaint; Docket Entry # 32, Ex. J). The 2001 Form 10-K shows 2001 net sales of $220,993,000 or "an increase of 55.6%" over 2000 net sales of $142,065,000. (¶ 115; Docket Entry # 32, Ex. J, p. F-4).

9. <u>April 24, 2002 Conference Call</u>

In an April 24, 2002 press release, Cytyc again announced "record" earnings for the first quarter of 2002. Cytyc reported net sales "of $68 million and net income of $17.6 million" or "increases of 43% and 58%, respectively, over the numbers for the

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not be able to complete the acquisition during the second quarter, or at all." (Docket Entry # 32, Ex. J).

[25] Plaintiffs contend that a reasonable inference from this statement is that Cytyc only offered a one time discount. They point to the April 24, 2002 conference call as supporting this inference. On its face, however, the statement refers to "discounts," not "a discount." Thus, the language of the statement, which refers to the plural "discounts" when describing the discounting in the past, coupled with the fact that the 2000 Form 10-K also notes that Cytyc has offered "discounts" in the past to stimulate demand makes the inference unreasonable.

first quarter 2001." (¶ 117; Docket Entry # 32, Ex. K). It also reported a market share of 64%. (¶ 117). The company scheduled a conference call after the close of trading.

The conference call began by cautioning listeners not to rely on forward looking statements. (Docket Entry # 32, Ex. L). During the conference call, Bowen noted that the company's current estimate for the year 2002 is "between $0.55 and $0.60 per share" (Docket Entry # 32, Ex. L, p. 11), a downward departure from the $0.64 to $0.66 estimate forecast by Sullivan during the January 24, 2002 Bloomberg News interview.

The complaint states that during the conference call, Cytyc explained that "its larger customers were 'tightening inventory'"[26] and "that the inventory problem had manifested itself only in the first quarter of 2002." (¶¶ 124 & 125). The actual transcript reveals the following statements regarding inventory:

> Bowen: . . . Selected large lab ordering patterns shifted lower in the first quarter due to what we believe was an imbalance in physician demand versus existing lab inventory levels or a change in inventory management practice at the lab.
>
> Also during the quarter we implemented a promotional program directed at smaller labs, which was well received. Although we believe that underlying demand at large and small labs continues to increase, in light of first quarter actions by selected large labs, consolidation in the lab industry and the response to our first quarter and promotional program at smaller labs, we anticipate a decline in near term shipment levels.

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[26] See footnote 28.

(Docket Entry # 32, Ex. L, p. 10).[27]

Thus, with regard to the inventory problem manifesting "itself *only* in the first quarter of 2002" (¶ 125, emphasis supplied), the actual transcript shows that both Bowen and Sullivan noted a change or shift in ordering patterns in the first quarter. The complaint alleges that the statement was false or misleading because it fails to disclose the "systemic and continuous channel stuffing" as well as the shipment of unordered product and customer alienation. (¶ 126).

When asked to "flush out" this sales promotion, Sullivan explained that Cytyc introduced the sales promotion as a response to "a change in ordering pattern at selected larger labs. That change in ordering pattern we believe was either due to an imbalance at the lab in physician demand versus their existing inventory levels at that time or a change in the way in which they choose to manage their ThinPrep Pap Test inventory levels." (Docket Entry # 32, Ex. L, p. 13). In essence, both Bowen and Sullivan disclosed that selected larger laboratories had an inventory "imbalance" and "ordering patterns shifted lower in the first quarter."[28] (Docket Entry # 32, Ex. L, pp. 10 & 13). As a

[27] Plaintiffs do not expressly object to considering the transcript of the conference in defendants' appendix and referred to in the complaint. <u>See</u> <u>Shaw v. Digital</u>, 82 F.3d at 1220; <u>Watterson v. Page</u>, 987 F.2d at 3.

[28] The complaint describes the "tightening inventory" statement, which originates from a Bloomberg News report, as misleading because Cytyc omitted that the inventory tightening stemmed from the channel stuffing. (¶ 124; "Cytyc failed to state that its largest customers had been stuffed with so much extra inventory that there was no need for those customers to

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result, the company offered a promotional program to smaller laboratories during the first quarter.

During the conference call, Sullivan explicitly advised the audience that, "This is not the first time-the first quarter that we've ever had promotional type programs." (Docket Entry # 32, Ex. L, p. 16). Bowen gave a more positive description explaining that, "We don't expect to have promotional programs in the small labs going forward, and what we expect to do is have our pricing patterns return to what we would consider to be the norm."[29] (Docket Entry # 32, Ex. L, p. 16).

After the conference call, a number of analysts made statements that plaintiffs seek to attribute to Cytyc. One such third party statement derives from a UBS Warburg report wherein the analyst states that Cytyc stated during the conference call

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order any more product for a long time to come").

The Bloomberg News article, dated April 25, 2002, reads as follows:

> Big laboratories are tightening inventory, and Cytyc offered incentives to smaller labs, analysts said. "The big concern is there's an inventory pushback on the part of large labs," said Banc of America Securities analyst Kurt Kruger, who rates Cytyc 'buy.' "The company scrambled to provide some discounts to small labs to offset this."

(¶ 119, quotation marks taken from complaint). Defendants argue, inter alia, that the report fails the entanglement test.

[29] Sullivan's remark not only shows that Cytyc disclosed, again, the discounts, but also militates against a finding of scienter. Given Sullivan's description, Bowen's description shows at most negligence and the attempt to put a good face on the disclosure. The forward looking remark, which in any event is *not* particularized in the complaint, also falls under the safe harbor provision of the PSLRA. The market was not fooled inasmuch as Cytyc stock dropped precipitously the following day.

that it had "'instituted a one-time promotion for the smaller labs to drive conversion at these customers in the quarter.'"[30] (¶ 121). During the conference call, however, Sullivan explicitly disclaimed that the promotion was a one time offer. (Docket Entry # 32, Ex. L, p. 16).

In addition to the Bloomberg News article and the UBS Warburg analyst's comments, an April 25, 2002 Pacific Growth Equities analyst report states that, "a 'change in the ordering and inventory practices of Cytyc's large lab customers necessitated a special promotion targeting smaller labs in order for Cytyc to meet Q1 expectations.'"[31] (¶ 120). As a result, the report explains, "'Cytyc lowered forward guidance.'"[32] (¶ 120).

In response to the April 24, 2002 disclosure, Cytyc common stock fell from $24.80 per share on April 24 to $15.73 per share

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[30] Plaintiffs seek to hold Cytyc responsible for this third party statement of the promotion as a "'one-time'" event. They submit the description is misleading inasmuch as Cytyc engaged in a continuous pattern of channel stuffing throughout the class period.

[31] There is nothing false or misleading about the statement that Cytyc offered a "special promotion." Cytyc did offer a special promotion. There was no duty to also add, "as we've done a number of times in the past." As argued by defendants (Docket Entry # 31, pp. 22-25 & n. 14), the complaint fails to sufficiently pled why the statement was false or misleading. The third party statement attributing the statement to "Cytyc" also fails the entanglement test described _infra_.

[32] In particular, the report states that, "Cytyc's recent experience with shifting laboratory inventory practices led to lowered guidance for Q2 and the remainder of 2002." (Docket Entry # 32, Ex. N).

at the close of trading on April 25. (¶ 129). In May and June, members of Cytyc's sales force discussed whether the stock "would plummet further." (¶ 132).

During the April 24, 2002 conference call, Sullivan intimated that Cytyc was going to try to cue its business more closely to physician demand. According to Sullivan, Cytyc would try to have a leaner "supply chain" and a better understanding of inventory at the laboratories. (Docket Entry # 32, Ex. L, p. 24). In May and June 2002, Cytyc executives informed the salesforce "that 'they were changing the market strategy to have more stable shipments so that we wouldn't be flooded at the end of the quarters,'" according to the former Cytyc manufacturing manager. (¶ 131; see also ¶ 156). The company, however, continued to pressure the sales force to meet the quotas, according to the former Cytyc CA account executive.[33] (¶ 131).

At least one market analyst viewed the Cytyc issue as short term. According to his or her June 21, 2002 report, "'We believe that some of the short term issues, mainly inventory in the

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[33] The former Cytyc manufacturing manager related that in May and June 2002:

> I heard that the stock is probably going to take a downswing, because of the fact that the channels are flooded. I asked, well how did the channels get that flooded? That became the first time that someone in distribution explained to me that the sales people were under pressure to make deep discounts [in order to convince customers] to buy bigger quantity at the end of quarters in order to meet the goals to keep the revenues up so that the stock price could be maintained.

(¶ 132).

channels . . . will be resolved over the next six weeks.'" (¶ 134). On June 24, 2002, however, Cytyc issued a press release further lowering the company's expected revenues for 2002 to a "'range of $230 million to $245 million, with pro forma earnings of $0.40 to $0.44 per share.'" (¶ 137).

During the conference call the following day, "Cytyc representatives explained that the downward revision was necessitated because of the method of gauging demand for ThinPrep that Cytyc had been using, which had been based on shipments to laboratories, overestimated end-user demand." (¶ 138). Cytyc also announced a change in revenue recognition "to a system that was more reflective of end-user demand." (¶ 138).

The market negatively reacted to the news and the price of Cytyc shares feel from $11.46 per share on June 24 to $6.88 per share at the close of trading on June 25, 2002. In contrast to the 64% market share Cytyc reported for the first quarter of 2002 in the April 24, 2002 press release, a Thomas Weisel Partners LLP analyst posited that, "'we believe the ThinPrep Test had a 50.0% market share at the end of 1Q02.'" (¶¶ 117 & 140). Another market analyst likewise depicted "'an inventory overhang of $32-35 million that needs to work its way through the lab channel for Cytyc to put this issue behind it." (¶ 141).

As a further means to infer scienter, the complaint notes that Sullivan and Bowen controlled the content of Cytyc press releases and SEC filings and could therefore falsify information about Cytyc's performance and products. (¶ 147). Intimately

involved in the company, both Sullivan and Bowen were kept informed "on an ongoing basis" about the company's problems. (¶¶ 148-149).[34] Both Sullivan and Bowen, described as "very hands-on managers," attended sales meetings where Cytyc management stressed the importance of meeting sales expectations, according to the former Cytyc CA account executive and the unnamed human resources representative. (¶¶ 153 & 154).

Sullivan also purchased Cytyc stock during the class period. More specifically, on December 6, 2001, Sullivan sold 55,000 shares of Cytyc common stock at a price of $24.90 per share. He sold an additional 20,000 shares the following day, also for $24.90 per share. Gross proceeds totaled $1,867,500 or approximately four times Sullivan's annual salary.

The amount, however, represents approximately 10% of Sullivan's Cytyc holdings. The $24.90 share price was not the high during the class period, which briefly hovered around $30.00 per share in October 2001. (Docket Entry # 32, Ex. R).[35] Even more significant, Sullivan's sales during the class period are less than his sales both prior to and after the class period.

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[34] The complaint does not attribute the statement to anyone or provide a time frame.

[35] Although the data is attached to defendants' opposition, it is appropriate to take judicial notice of the sales price during the class period on a motion to dismiss. In Re NAHC, Inc. Securities Litigation, 306 F.3d 1314, 1331 (3rd Cir. 2002) (affirming lower court's decision to take judicial notice of stock price data on motion to dismiss). Plaintiffs did not object to the submission. In any event, the complaint reflects a class period high of $27.52 (¶ 10), a price still in excess of the price Sullivan sold his shares.

For example, Sullivan sold 130,800 shares or approximately 15% of his holdings in April 2001 and 189,930 shares or approximately 22% of his holdings in December 2002. (Docket Entry # 32, Ex. Q).[36]

C. Cytyc's Revenue Recognition Policy

As a result of the end of quarter discounts, Cytyc pushed sales into earlier quarters than normally would have occurred. Customers also accumulated inventory in amounts that they did not immediately use. Improper recognition of revenue materially inflated the company's reported results making the financial statements misleading or false, according to the complaint.

Plaintiffs allege that the channel stuffing as well as the shipments of additional and unordered product violated the company's revenue recognition policy, GAAP and SEC regulations[37]

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[36] Where, as here, plaintiffs raise an allegation of insider trading (see Docket Entry # 36, p. 43) and do not challenge the authenticity of the public documents, this court may consider the entirety of the Form 4 filings without converting the motion to dismiss into a motion for summary judgment. See In Re Stone & Webster, 253 F.Supp.2d at 128 & n. 11 (considering copies of SEC Forms 4 without converting motion to dismiss into motion for summary judgment); In Re Millstone Scientific Securities Litigation, 103 F.Supp.2d at 450-451 & n. 15 (considering numerous SEC public filing documents without converting motion to dismiss into motion for summary judgment and noting that court may consider "matters of public record" and "documents referred to in the complaint"); see also Blackstone Realty, LLC v. FDIC, 244 F.3d at 195 n. 1 (exhibits attached to complaint properly considered for purposes of Rule 12(b)(6), Fed. R. Civ. P.); Watterson v. Page, 987 F.2d at 3.

[37] The complaint (¶ 55) correctly notes that under an SEC regulation, 17 C.F.R. § 210.4-01(a)(1), "filings that do not comply with GAAP "'will be presumed to be misleading and inaccurate.'" In Re Cabletron Systems, Inc., 311 F.3d 11, 34

thereby evidencing a strong inference of scienter. Plaintiffs maintain that Cytyc's channel stuffing violates certain provisions of the Financial Accounting Standards Board ("FASB"), SEC Staff Accounting Bulletin 101 ("SAB 101"), FASB Statement of Financial Accounting Standards ("SFAS") and an opinion of the Accounting Principles Board ("APB").[38] The complaint alleges that during the class period, the financial statements of Cytyc violated the following principles of fair financial reporting:

(1) the principle that financial reporting should provide accurate, reliable and useful information concerning an entity's performance and that investors commonly use the company's performance in the past as a reliable indicator of the company's performance in the future (¶¶ 54 & 61, citing FASB Concepts Statement No. 1; ¶¶ 34, 42 & 58-59);[39]

(2) the principle that revenues should not be recognized until "realized or realizable and earned" (¶ 56, citing FASB Concepts Statement No. 5, ¶ 83; SAB 101; FASB Concepts Statement

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(1st Cir. 2002) (citing to 17 C.F.R. § 210.4-01(a)(1)).

[38] GAAP "'are the official standards adopted by the American Institute of Certified Public Accountants (the "AICPA"), a private professional association, through three successor groups that it established, the Committee on Accounting Procedure, the Accounting Principles Board (the "APB"), and the Financial Accounting Standards Board (the "FASB").'" In Re Enron Corporation Securities, 235 F.Supp.2d 549, 572 n. 11 (S.D.Tx. 2002). The complaint cites inter alia to FASB Concepts Statements 2, 5, 33, 34, 41, 42, 58, 59 and 83.

[39] In relation to this category, the complaint further notes that by pulling in revenues from future quarters into earlier quarters, defendants violated FASB Concepts Statement Number One because reported revenues in the earlier quarters were not reliable representations of revenues. (¶ 62).

No. 2; SFAS No. 48;[40] Accounting Research Board No. 43; APB opinion 10; ¶¶ 57, 59 & 80, all citing SAB 101);[41] and

(3) the principle requiring companies to "describe known trends or uncertainties" that have a material effect on sales and revenues in all Form 10-K and 10-Q reports, particularly those events known to management that would cause reported financial information not to be reflective of future operating results (¶¶ 63-66, citing 17 C.F.R. § 229.303).[42]

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[40] SFAS 48 circumscribes declaring revenue when a right of return exists. See generally Aldridge v. A.T. Cross Corporation, 284 F.3d at 79. There are no particular allegations that ThinPrep shipments were returned or that such shipments amounted to contingent sales. Moreover, under SFAS 48 allowing a right of return in a particular transaction "does not per se mean that revenue cannot be recognized at the time of sale." In Re Focus Enhancements, Inc. Securities Litigation, 309 F.Supp.2d 134, 151 (D.Mass. 2001).

Alternatively, the complaint's brief reference to the regulation, without more, is conclusory and lacks the necessary pleading detail required under the PSLRA. See Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d 12, 35 (D.Mass. 2000).

[41] Although revenue does not have to be received before recognized, there should be "persuasive evidence of an arrangement." (¶ 56). In other words, there should be evidence of delivery and a fixed price such that "collectability of the sales price is reasonably assured." (¶ 56). There must be sufficient evidence of an arrangement. (¶ 80, quoting SAB 101).

[42] The pertinent SEC regulation imposes a duty on registrants to:

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.

17 C.F.R. § 229.303(a)(3)(ii).

The company's financial statements during the class period and the 2001 Form 10-K contain the company's stated policy for revenue recognition. The policy corresponds to SAB 101 and reads as follows:

> The Company recognizes product revenue upon shipment, provided that there is persuasive evidence of an arrangement, there are no uncertainties regarding acceptance, the sales price is fixed or determinable, collection of the resulting receivable is probable and only perfunctory Company obligations included in the arrangement remain to be completed.

(¶¶ 58 & 78; accord Docket Entry # 32, Ex. J, p. F-7). The 2001 Form 10-K elsewhere describes Cytyc's policy in a similar manner:

> The Company follows very specific and detailed guidelines in measuring revenue; *however, certain judgments affect the application of its revenue policy. For example, revenue is not recognized from sales transactions unless the collection of the resulting receivable is reasonably assured. The Company assess[sic] collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer.* If it is determined that the collection fee is not reasonably assured, the fee is deferred and revenue is recognized at the time collection becomes reasonably assured, which is generally upon receipt of cash.

(¶ 112, emphasis in complaint; Docket Entry # 32, Ex. J, p. 20).

Cytyc's channel stuffing purportedly improperly pulled revenue from future quarters into previous quarters. (¶ 62, citing FASB Concepts Statement No. 1; ¶¶ 33, 41 & 58-59). Because of Cytyc's practice of channel stuffing, the Forms 10-K and 10-Q covering the class period failed to disclose that current revenues were achieved at the expense of future revenues. (¶ 66). The forms thereby mischaracterized current financial growth and failed to disclose known trends in violation of 17 C.F.R. § 229.303, according to the complaint. (¶ 66).

DISCUSSION

A. Essential Elements of Securities Fraud Liability

Liability under Section 10(b), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, requires the plaintiff to plead with particularity that, in connection with the sale or purchase of a security, the defendant: (1) "made a false statement or omitted a material fact;" (2) "with the requisite scienter;" and that (3) the "plaintiff relied on the statement or omission;" (4) "with resultant injury." In Re Boston Technology, Inc. Securities Litigation, 8 F.Supp.2d 43, 52 (D.Mass. 1998); accord Gross v. Summa Four, Inc., 93 F.3d 987, 992 (1st Cir. 1996) (the "plaintiff must plead, with sufficient particularity, that the defendant made a false statement or omitted a material fact, with the requisite scienter, and that the plaintiff's reliance on this statement or omission caused the plaintiff's injury"). The circumstances in the case at bar primarily concern the first and second elements.

Under the first element, the plaintiff must allege that a defendant either: "'(A) made an untrue statement of a material fact; or (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading.'" Baron v. Smith, 380 F.3d 49, 52 (1st Cir. 2004) (quoting 15 U.S.C. § 78u-4(b)(1)). The falsity or untruth of the various statements presents a relatively straight forward analysis. The misleading nature of the statements poses a more exacting inquiry.

In order to create liability for an omission, as opposed to an affirmatively stated falsehood, there must be a duty to disclose the omitted nonpublic information. Gross v. Summa Four, Inc., 93 F.3d at 992 ("corporation must first have a duty to disclose the nonpublic material information"); Shaw v. Digital Equipment Corporation, 82 F.3d at 1202 ("silence, absent a duty to disclose, cannot be actionably misleading"). Simply reporting past historical earnings or successes does not give rise to a duty to report present circumstances which are less rosy. Suna v. Bailey Corporation, 107 F.3d 64, 68 (1st Cir. 1997). For example, if a corporation accurately reports that, "'This is our eighth consecutive quarter in which our gross has increased,'" there is not duty to add, "'We are concerned about the next one.'" Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d 357, 361 n. 4 (1st Cir. 1994) (further noting the rule may be different if the defendant apprehends "'a disaster'").

Where, however, "a corporation does make a disclosure--whether it be voluntary or required--there is a duty to make it complete and accurate." Gross v. Summa Four, Inc., 93 F.3d at 992; Backman v. Polaroid Corporation, 910 F.2d 10, 16 (1st Cir. 1990) ("voluntary disclosure that a reasonable investor would consider material must be complete and accurate"); In Re Boston Technology, Inc. Securities Litigation, 8 F.Supp.2d at 54 ("when an issuer opts to make a statement, that statement must be 'complete and accurate'"); see also Lucia v. Prospect Street High Income Portfolio, Inc., 36 F.3d 170, 175 (1st Cir. 1994)

(recognizing that statement can be literally accurate but nonetheless misleading). A duty thus arises where, for instance, "a corporation has previously made a statement of material fact that is either false, inaccurate, incomplete, or misleading in light of the undisclosed information." Gross v. Summa Four, Inc., 93 F.3d at 992; see Carney v. Cambridge Technology Partners, Inc., 135 F.Supp.2d 235, 242 (D.Mass. 2001) ("'duty to disclose arises only where both the statement made is material, and the omitted fact is material to the statement in that it alters the meaning of the statement'"); see also Shaw v. Digital Equipment Corporation, 82 F.3d at 1202-1203 ("task depends, in essence, on conceptions of materiality").

It is equally well settled that the false or omitted fact must be "material." An omitted or misrepresented fact is "considered material only if a reasonable investor would have viewed the misrepresentation or omission as 'having significantly altered the total mix of information made available.'" Gross v. Summa Four, Inc., 93 F.3d at 992; accord In Re Cabletron, 311 F.3d at 33 ("fact is material if it is substantially likely that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"). "Information which would have assumed actual significance in the deliberations of a reasonable shareholder is material." Baron v. Smith, 380 F.3d at 52. Issues of materiality are normally left for the "jury rather than resolved by the court on a motion to dismiss." In Re

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Cabletron, 311 F.3d at 34.

In addition to a materially false statement or the omission of a material fact, the plaintiff must show that the defendant acted with scienter. Scienter is "'a mental state embracing intent to deceive, manipulate, or defraud.'" Greebel v. FTP Software, 194 F.3d at 194 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n. 12 (1976)). It can be proven with knowing or reckless conduct. Geffon v. Micrion Corporation, 249 F.3d 29, 35 (1st Cir. 2001). Under the former, the plaintiff must show that the defendant "knew (i) that the statement was false or misleading, and (ii) that it was made in reference to a matter of material interest to investors." Geffon v. Micrion Corporation, 249 F.3d at 35. Under the latter, there must be a showing of "more than mere negligence." Geffon v. Micrion Corporation, 249 F.3d at 35. Recklessness, which is more akin to a lesser form of intent than ordinary negligence, Greebel v. FTP Software, Inc., 194 F.3d at 199, consists of "'a highly unreasonable omission, involving not merely simple, or even inexcusable, negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious the actor must have been aware of it.'" Geffon v. Micrion Corporation, 249 F.3d at 35; Orton v. Parametric Technology Corporation, 344 F.Supp.2d 290, 299 (D.Mass. 2004) (same).

B. Pleading Requirements

Greebel is the seminal case in this circuit with respect to

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pleading a securities action under Rule 9(b), Fed. R. Civ. P. ("Rule 9(b)"), and the PSLRA. Greebel v. FTP Software, 194 F.3d at 193-194; In Re Allaire Corporation Securities Litigation, 224 F.Supp.2d 319, 325 (D.Mass. 2002). As explained in Greebel, the pleading standards under the PSLRA are congruent to the First Circuit's strict and rigorous application of Rule 9(b) prior to the 1995 enactment of the PSLRA. Greebel v. FTP Software, 194 F.3d at 192.

The pleading requirements under the PSLRA, as well as First Circuit caselaw interpreting Rule 9(b), first require the plaintiff to specify in the complaint "each allegedly false or misleading statement 'including its time, place and content.'" In Re Allaire Corporation Securities Litigation, 224 F.Supp.2d at 324 (quoting Greebel v. FTP Software, 194 F.3d at 193-194). Second, the complaint must "'specify the reason or reasons why the statement is misleading.'" Greebel v. FTP Software, 194 F.3d at 193 (quoting statute with internal brackets omitted). In other words, the complaint must explain and provide factual support as to "why the challenged statement or omission is misleading." Greebel v. FTP Software, 194 F.3d at 193; see In Re Allaire Corporation Securities Litigation, 224 F.Supp.2d at 324 ("[e]very claim that a statement or omission was fraudulent must be supported by facts showing exactly why it was misleading"). Third, if a claim rests on information and belief, the plaintiff must "'set forth the source of the information and the reasons for the belief.'" Greebel v. FTP Software, 194 F.3d at 194; In

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Re Allaire Corporation Securities Litigation, 224 F.Supp.2d at 324; see also In Re Cabletron, 311 F.3d at 28 (discussing inconsistency in definitions of what constitutes a statement made upon "information and belief").

Fourth, the complaint must state "with particularity facts that give rise to a 'strong inference' of scienter rather than merely a reasonable inference." In Re Cabletron, 311 F.3d at 28 (quoting statute). Although pleading scienter may and often is established through inference, the inference must be strong. In Re Cabletron, 311 F.3d at 28 (further explaining how this framework alters "the usual contours" of Rule 12(b)(6) analysis); Greebel v. FTP Software, 194 F.3d at 195 (same).[43]

Before exploring the absence of a strong inference of scienter with respect to any remaining statements, this court examines and rejects the revenue recognition allegations and the misleading nature of the discounting statement set forth in the financial statements as well as the allegations based upon unordered or additional product. Proceeding along a statement by statement analysis, see Carney v. Cambridge Technology Partners, Inc., 135 F.Supp.2d at 243; In Re Boston Technologies Securities Litigation, 8 F.Supp.2d at 55, this court then culls the actionable statements in the complaint as distinguished from the nonactionable statements of corporate puffery and those that fall within the safe harbor provision of the PSLRA for forward looking

[43] As also explained in Greebel, the PSLRA does not alter the pre-existing substantive definition of scienter employed in the First Circuit. Greebel v. FTP Software, 194 F.3d at 200.

statements.

C. Revenue Recognition

In support of pleading a strong inference of scienter as well as setting forth this material element, plaintiffs point to defendants' purported violations of SEC rules, GAAP and Cytyc's own revenue recognition policy.[44] (Docket Entry # 36, pp. 37-40). Separate and apart from the fact of this case, plaintiff's legal position is accurate. See Aldridge v. A.T. Cross Corporation, 284 F.3d at 83 (paraphrasing Geffon v. Micrion Corporation, 249 F.3d at 35, that "'accounting shenanigans' may be evidence of scienter"); In Re Cabletron, 311 F.3d at 39 ("[s]ignificant GAAP violations also 'could provide evidence of scienter'"); Greebel v. FTP Software, Inc., 194 F.3d at 203 ("[v]iolations of GAAP standards . . . could provide evidence of scienter"); In Re Galileo Corporation Shareholders Litigation, 127 F.Supp.2d 251, 266 (D.Mass. 2001) ("'a violation of a company's own policies supports an inference of scienter'").

Plaintiffs identify statements in the Forms 10-K regarding discounts as materially misleading (¶¶ 110-111 & 116) as well as the company's stated policy of recognizing revenue as materially misleading because the company engaged in channel stuffing. (¶¶ 112-114 & 116); see, e.g., In Re Cabletron, 311 F.3d at 34 (noting the allegation of financial report filings as materially

[44] Plaintiffs additionally contend that the violations of GAAP, SEC regulations and Cytyc's policy show the falsity or misleading nature of the statements made during the class period because revenue should not be recognized until realized or realizable. (See, e.g., ¶¶ 60-62).

misleading). Plaintiffs further complain that the company's financial statements were materially false and misleading because they inflated or overstated revenues, accelerated revenues into earlier quarters and failed to disclose known trends such as channel stuffing. (See, e.g.,[45] ¶¶ 52, 53, 56 & 66). Unfortunately for plaintiffs, none of these allegations survive defendants' motion.

Turning to the first two aforementioned global categories of revenue recognition violations, it is true that systemically recognizing revenues before earned and accounting for such premature revenues contravene GAAP principles set forth in FASB Concepts Statement Number One. See In Re Daou Systems, Inc. Securities Litigation, 2005 WL 237645 at * 8 (9th Cir. Feb. 2, 2005) ("premature recognition . . . could violate other GAAP principles such as" FASB Concepts Statement No. 1); (¶¶ 34 & 58-59; ¶ 61, citing these principles). It is also true that the cited regulations in the second category generally require that a company not recognize revenue in financial statements until "realized or realizable and earned."[46] (¶ 56; see also ¶¶ 57 & 79-80). For example, SAB 101, repeatedly referenced in the complaint (¶¶ 56, 57, 59 & 80), "requires that "'revenue should not be recognized until it is realized or realizable and

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[45] To state the obvious, the cited list of paragraphs is not exhaustive.

[46] Plaintiffs' citation to a litany of SEC regulations and accounting principles is conclusory and fails to explicitly tie the violation to a particular duty and accounting regulation.

earned.'" In Re BellSouth Securities Litigation, 2005 WL 327178 at * 16 (N.D.Ga. Feb. 8, 2005) (quoting SAB 101) Barrie v. Intervoice-Brite, Inc., 2005 WL 57928 at * 3 (5th Cir. Jan. 12, 2005) (further noting that SEC adopted SAB 101 "to guide companies in applying SEC Rules and GAAP to revenue recognition issues"). SEC regulations additionally state that filings that do not conform with GAAP are presumed to be misleading or inaccurate. (¶ 55); 17 C.F.R. § 210.4-01(a)(1); In Re Segue Software, Inc. Securities Litigation, 106 F.Supp.2d 161, 164 n. 4 (D.Mass. 2000).

The class period Forms 10-Q and 10-K, however, do not evidence improper revenue recognition under these regulations. The channel stuffing allegations (see, e.g., ¶¶ 68(f)) are not within the reach of the aforementioned regulations inasmuch as there is no evidence that ThinPrep shipments were returned or that Cytyc engaged in contingent sales, a pattern of undisclosed price protection and take back guarantees or reported revenue from fictitious sales. Cf. Aldridge v. A.T. Cross Corporation, 284 F.3d at 79 (involving price protection policy and contingent sales as opposed to only channel stuffing).[47] As aptly explained

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[47] The Aldridge case is distinguishable for the reasons set forth by defendants in their reply brief. (Docket Entry # 39, p. 16). Although defendants exaggerate the absence of specific statements, there remains the absence of contingent or fictitious sales, returned product or a pattern of price protection and take back guarantees in the case at bar. The facts fail to indicate that the discounts resulted in revenue not being realized, as reported. See Gross v. Summa Four, Inc., 93 F.3d at 994. Thus, there is an absence of factual support for the necessary element of falsity or material omissions with respect to the innocuous channel stuffing alleged in this action as applied to the alleged

by a court in this district:

> [P]ull-ins or deep discounts are not the nefariously manipulative scheme that plaintiffs make them out to be. Pull-ins do not result in the improper recognition of revenue under generally accepted accounting principles ("GAAP"). They are actual sales which are treated no differently than any other sale.

In Re Peritus Software Services, Inc., 52 F.Supp.2d 211, 223 n. 3 (D.Mass. 1999) (internal quotation marks, brackets and citations omitted). The facts fail to indicate that the discounts resulted in revenue not being realized, as reported and in accordance with the Cytyc's stated accounting or revenue recognition policy. See Gross v. Summa Four, Inc., 93 F.3d at 994. Stated otherwise, the excessive discounting did not prevent transactions from being completed. The financial statements accurately reflect earnings made upon and after persuasive evidence of an arrangement.

In any event, contrary to plaintiffs' position, the discounting was adequately disclosed. The Forms 10-K and 10-Q recognize the use of discounts and that such discounts could have a material adverse effect on Cytyc's financial condition. (Docket Entry # 32, Ex. B & J, "In the past, the Company has offered discounts to stimulate demand for the ThinPrep System and may elect to do so in the future, which discounts could have a

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GAAP, SEC and company policy violations.

Thus, while the number of former unnamed employees is sufficient and they occupy positions that give them a strong basis for possessing the information about the company's channel stuffing, see In Re Cabletron Systems, 311 F.3d at 30; Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d at 22, the stories themselves lack the necessary facts to support the allegation that Cytyc violated the aforementioned GAAP, SEC and its own revenue recognition rules.

material adverse effect on the Company's business, financial condition and results of operations;" Docket Entry # 32, Ex. D, incorporating risks detailed in the 2000 Form 10-K and that such risks "may have a material adverse effect upon on the Company's business, financial condition and results of operations").

Accordingly, Cytyc's stated accounting or revenue recognition policy as well as the statement regarding discounts (¶¶ 110-116) in the financial statements neither contravenes the aforementioned regulations in the first and second categories nor amounts to a false or misleading statement.[48] Also in this respect, there is no inference of scienter due to the absence of a violation of the foregoing GAAP and SEC provisions and Cytyc's revenue recognition policy or otherwise.[49]

The final category of allegedly improper revenue recognition which arises under Item 303 of 17 C.F.R. § 229.303 is likewise unavailing.[50] First, although the complaint expressly complains about the failure of the Forms 10-K and 10-Q to disclose the use

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[48] Additional reasons explaining why the discount statement is not misleading or false are discussed <u>infra</u>.

[49] Even if such activity gave rise to a weak inference of scienter, without more, the complaint fails to pled the strong inference of scienter now required under the PSLRA.

[50] The regulation, 17 C.F.R. § 229.303(a) and (b), commonly referred to as "Item 303," governs Form 10-K and 10-Q filings. Item 303 "requires corporate management to disclose, inter alia, 'any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations . . ..'" Kafenbaum and Schulman v. GTECH Holdings Corporation, 217 F.Supp.2d 238, 249 (D.Mass. 2002).

of discounts as a known trend "'that would cause reported financial information not to be necessarily indicative of future operating results'" (¶¶ 64 & 66, quoting instructions to Item 303), the rule in "Item 303, 17 C.F.R. § 229.303(a)(3)(ii), . . . has to be read in light of the SEC's instruction to this paragraph which expressly states that forward-looking information need not be disclosed. 17 C.F.R. § 229.303(a), Instruction 7." Glassman v. Computervision Corporation, 90 F.3d 617, 631 (1st Cir. 1996); accord Romine v. Acxiom Corporation, 296 F.3d 701, 708 n. 3 (8th Cir. 2002) ("While § 229.303(a)(3)(ii) provides that 'known trends or uncertainties' be disclosed in certain SEC filings, another SEC regulation, which expressly addresses forecasts, states that forward-looking information need not be disclosed. 17 C.F.R. § 229.303(a)").

Second, it is not objectively unreasonable to omit the fact that the discounts, or channel stuffing, "would" as opposed to "could" have a material adverse effect on the company's future earnings. See, e.g., Oxford Asset Management, Limited v. Jaharis, 297 F.3d 1182, 1191 (11th Cir. 2002) ("failure to allege facts from which the objective unreasonableness of Kos management's decision not to include the prescription information . . . could be inferred forecloses reliance upon Item 303 as a source of a duty to disclose that information"), cert. denied, 540 U.S. 872 (2003). In addition, the import of the language was obvious making the distinction between "could" and "would" immaterial. See Baron v. Smith, 285 F.Supp. 96, 104 (D.Mass.

2003) ("where company disclosed that largest customer began 'trial' of service product, it was not necessary also to disclose that customer had not committed to purchasing service, since uncertainty of commitment to purchase was obvious from word 'trial'") (paraphrasing <u>In Re Boston Technologies Securities Litigation</u>, 8 F.Supp.2d at 61), <u>aff'd</u>, 380 F.3d 49 (1st Cir. 2004). Finally, although the information regarding discounts appears in the Forms 10-K under "marketing and sales" as opposed to under "results of operations," the placement, without more, is not actionable.[51]

Third, the Forms 10-K directly and the Form 10-Q by incorporation adequately disclosed the use of discounts. <u>See</u>, <u>e.g.</u>, <u>Shaw v. Digital Equipment Corporation</u>, 82 F.3d at 1206 (disclosure of marketing strategy in reducing prices adequately disclosed in SEC filings thereby obviating alleged violation of 17 C.F.R. § 229.303); <u>Baron v. Smith</u>, 380 F.3d at 54-56.

D. <u>Unordered and Additional Product</u>

Recognizing as revenue unordered product or shipping additional product without an order, as distinguished from channel stuffing through the use of deep discounts, is more egregious and poses a more forceful argument that Cytyc engaged in conduct in violation of its own or SEC and GAAP revenue recognition requirements. With respect to unordered or additional product, however, the complaint falls well short of

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[51] The Form 10-Q refers to the risk factors in the annual Form 10-K report without expressly listing the use of discounts.

providing sufficient detail to satisfy Rule 9(b) and the PSLRA. See In Re Galileo Corporation, 127 F.Supp.2d at 268 (generally alleging that revenues in second quarter were false and failing to provide details about amount of warranty reserve understatement made pleading deficient under Rule 9(b) and PSLRA); Fitzer v. Security Dynamics Technologies, 119 F.Supp.2d at 35-36 (channel stuffing allegations deficient under Rule 9(b) and PSLRA); Lirette v. Shiva Corporation, 27 F.Supp. 268, 278 (D.Mass. 1998).

In contrast to the repeated and numerous allegations of channel stuffing on the part of former Cytyc employees,[52] the complaint provides few particulars about the when, where, amount and nature of the transactions of unordered product and the relationship between the amount of unordered product shipped and the company's total revenues. The two instances of shipment of additional product related by the former Cytyc senior representative (¶ 44) and the former Cytyc sales representative (¶ 38) are too general and lack repeated corroboration to satisfy PSLRA pleading. Cf. In Re Cabletron, 311 F.3d at 30-31. Thus, the instances of unordered product or shipment of additional product above what had been ordered (see ¶¶ 5, 7, 44, 49, 61 & 82(c)), as distinguished from the deep discounting at the end of every quarter and/or "channel stuffing," lack detail and corroboration by other employees. Eschewing a categorical approach, see In Re Cabletron, 311 F.3d at 32 (rejecting

[52] See footnote number 47, ¶ 2.

"categorical approach" and noting that "'Congress was concerned with the quantum, not type, of proof'"), the complaint lacks the "quantum" of proof and particularity to satisfy the PSLRA with respect to the shipments of unordered or additional product. Accordingly, such allegations cannot support a finding that Cytyc's stated revenue recognition policy or the use of discounts or other channel stuffing activity was false or misleading or that defendants acted with scienter.

E. Specific Statements

Defendants attack a number of the statements in the complaint as nonactionable corporate puffery or falling within the PSLRA's safe harbor provision for forward looking statements.

As to the former, "Vague and loosely optimistic statements" are "nonactionable as a matter of law." Gross v. Summa Four, Inc., 93 F.3d at 987 (affirming dismissal of complaint). This rule applies to statements concerning both current affairs and future prospects. Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 300 ("corporate puffery rule 'covers loose optimism about both an issuer's current state of affairs and its future prospects'"); In Re Boston Technology, Inc. Securities Litigation, 8 F.Supp. at 54 (same). "Rosy affirmation[s] commonly heard from corporate managers," such as we "expect another year of strong growth" or "the company is on target toward achieving the most profitable year in its history," are "numbingly familiar." Shaw v. Digital Equipment Corporation, 82 F.3d at 1217-1218 (internal quotation marks and citations

omitted). Consequently, "no reasonable investor could find" such "optimistic" or "vague" statements "important to the total mix of information." Shaw v. Digital Equipment Corporation, 82 F.3d at 1217. In the parlance of common law fraud, such statements amount to "'puffing' or 'sales talk.'" Shaw v. Digital Equipment Corporation, 82 F.3d at 1217 n. 32.

The more specific, definite or concrete the outward statement is, however, the greater the likelihood the statement is material and not mere puffery. See Gross v. Summa Four, Inc., 93 F.3d at 995 (distinguishing the actionable statements in Alfus v. Pyramid Technology Corporation, 764 F.Supp. 598 (N.D.Cal. 1991), from inactionable statements in that case because "statements in Alfus dealt with definite projections," such as a forecast of 40% revenue growth). For example, the inclusion of "a market share figure" might push a nonactionable statement beyond the realm of "mere optimistic corporate puffery." Fitzer v. Security Dynamics Technologies, 119 F.Supp.2d at 26 (finding phrase "'continued market demand'" vague and optimistic in part because phrase did not specify "market share figure"). Similarly, more cautious or subdued statements are less likely to be actionable than more strongly optimistic or concrete statements that contrast sharply with internal reality. See Glassman v. Computervision Corporation, 90 F.3d at 635-636 (duty to disclose problems with new product "may arise where a company makes strongly optimistic or concrete statements . . . in stark contrast to its internal reports" as opposed to "subdued

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generally optimistic statements" that amount to "puffery," citing San Leandro Emergency Medical Group Profit Sharing Plan v. Philip Morris Companies, Inc., 75 F.3d 801, 811 (2nd Cir. 1996)). "[M]ild statements of hope, couched in strongly cautionary language," are not materially misleading. Glassman v. Computervision Corporation, 90 F.3d at 636.

Defendants also rely on the PSLRA's safe harbor provision with respect to a number of the forward looking statements in the complaint. Generally speaking, forecasts or other forward looking statements are not exempt from liability. Suna v. Bailey Corporation, 107 F.3d at 70. They are, however, only actionable "if the forecast might affect a reasonable investor in contemplating the value of a corporation's stock." Suna v. Bailey Corporation, 107 F.3d at 70 (internal quotations marks and citation omitted). In addition, there must be a showing that the forecast was false or misleading, in other words, that facts known by the forecaster at the time of the forecast (as distinguished from simply fraud by hindsight) made the anticipated forecast or success unlikely. See Suna v. Bailey Corporation, 107 F.3d at 70 (had the plaintiff "presented facts known by Bailey, and contemporaneous with the statements above, that would show that Bailey's anticipated success was unlikely, such facts would have adequately alleged a claim of securities fraud").

The PSLRA provides a safe harbor provision for forward looking statements that include cautionary warning[s]. Analogous

to the "bespeaks caution" doctrine, see H.R. Conf. Rep. No. 104-369, * 44 (1995) ("[t]he Conference Committee safe harbor, like the Senate safe harbor, is based on aspects of SEC Rule 175 and the judicial created 'bespeaks caution' doctrine"), the relevant provision in 15 U.S.C. § 78u-5(c)(1)(A)(i) "shelters forward-looking statements that are accompanied by meaningful cautionary statements." Greebel v. FTP Software, Inc., 194 F.3d at 201; 15 U.S.C. § 78u-5(c)(1)(A)(i). The statutory language precludes liability for a forward looking statement that is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement" or is "immaterial."[53] 15 U.S.C. § 78u-5(c)(1)(A)(i) & (ii). The Conference Committee's discussion clarifies that "'[i]mportant' factors means [that] the stated factors identified in the cautionary statement must be relevant to the projection."[54] H.R. Conf. Rep. No. 104-369, * 44

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[53] The inclusion of the latter language simply clarifies that, "Courts may continue to find a forward-looking statement immaterial-and thus not actionable under the 1933 Act and the 1934 Act-on other grounds" irrespective of the statutory safe harbor provision." H.R. Conf. Rep. No. 104-369, * 43 (1995).

[54] The following parts of the committee's discussion are illuminating:

> The cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statement, such as, for example, information about the issuer's business. As part of the analysis of what constitutes a meaningful cautionary statement, courts should consider the factors identified in the statements. "Important" factors means the stated factors identified in

(1995) (further noting that "boilerplate warnings will not suffice"). On the other hand, the cautionary statement does not necessarily have "to include the particular factor that ultimately causes the forward-looking statement not to come true."[55] H.R. Conf. Rep. No. 104-369, * 44 (1995).

> the cautionary statement must be relevant to the projection and must be of a nature that the factor or factors could actually affect whether the forward-looking statement is realized.
>
> The Conference Committee expects that the cautionary statements identify important factors that could cause results to differ materially-but not all factors. Failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor. The Conference Committee specifies that the cautionary statements identify "important" factors to provide guidance to issuers and not to provide an opportunity for plaintiff counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made.
>
> The use of the words "meaningful" and "important factors" are intended to provide a standard for the types of cautionary statements upon which a court may, where appropriate, decide a motion to dismiss, without examining the state of mind of the defendant. The first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement. Courts should not examine the state of mind of the person making the statement.

H.R. Conf. Rep. No. 104-369, * 44 (1995).

[55] The April 24, 2002 conference call fits comfortably within this framework. Although plaintiffs complain that the warnings in the conference call were simply boilerplate, the warnings were specific, detailed and relevant to the projection. Contrary to plaintiffs' position, the omission of the discounts and inventory does not dispel the specificity of the warning and prevent it from being sufficient under the PSLRA. This is particularly true where, as here, the warning refers the investor to the company's SEC filings and the 2001 Form 10-K expressly advised the investor about the company's use of discounts. The forward looking statements in the conference call therefore lie

The safe harbor provision also extends to oral statements in a less exacting manner. It allows a company to rely on this safe harbor when making an oral statement by simply referring to the written document containing the cautionary language. 15 U.S.C. § 78u-5(c)(2); see H.R. Conf. Rep. No. 104-369, * 45 (1995).

The analogous "bespeaks caution" doctrine precludes liability for forecasts and projections where the context of the forecast bespeaks caution. Shaw v. Digital Equipment Corporation, 82 F.3d at 1213-1214. Under this doctrine, the forward looking statement is not materially misleading if "accompanied by adequate cautionary disclosures." In Re Focus Enhancements, Inc. Securities Litigation, 309 F.Supp.2d at 162. Like the statutory safe harbor provision, the cautionary language under the bespeaks caution doctrine must be "'sufficiently related in subject matter'" as opposed to "merely boilerplate." In Re Focus Enhancements, Inc. Securities Litigation, 309 F.Supp.2d at 162. Summarily stated, the doctrine "embodies the principle that when statements of 'soft' information such as forecasts, estimates, opinions, or projections are accompanied by cautionary disclosures that adequately warn of the possibility that actual results or events may turn out differently, the

within the safe harbor.

Furthermore, although not argued or addressed by the parties, the conference call was an oral warning at the time it was given even though it is now reduced to a transcript. As explained in the next paragraph, such oral statements do not require the level of specificity required for written statements. In any event, the warning is sufficient for either a written or oral forward looking statement.

'soft' statements may not be materially misleading under the securities laws." Shaw v. Digital Equipment Corporation, 82 F.3d at 1213.

With the foregoing principles in mind, including the adequacy of the pleading under Rule 9(b) and the PSLRA, this court turns to the statements in the complaint.

The July 25, 2001 statement that growth is "driven by our proven market strategy, best-in-class sales team, and superior technology" is not actionable due to the failure to articulate or establish a basis for the statement's false or misleading nature. See Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 300 (distinguishing the actionable fueling growth statement in In re Allaire Corporation Securities Litigation, 224 F.Supp.2d at 331-332). Plaintiffs fail to allege that the market strategy or the sales team or the superior technology is not "without any positive impact on [Cytyc's] performance." Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 299 (statement that credited "company's separation of business units and focus on product sales for Parametric's financial performance" as opposed to undisclosed improper revenue recognition deemed inactionable because "[p]urchasers . . . have not alleged that Parametric's strategic business decisions were without any positive impact on their performance"). Nowhere does the complaint particularize with the requisite specificity that Cytyc's growth was not assisted by the company's market strategy, sales team and superior technology. See also Orton v. Parametric Technology

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Corporation, 344 F.Supp.2d at 301-302 (statement that "we executed well this quarter" and "believe our strategic efforts in this past year in developing software solutions, expanding distribution and improving customer satisfaction are helping us to expand our leadership position as the product development company" lacked "requisite specificity" because "the plaintiffs have not alleged . . . that Parametric had executed its software development, product distribution, or customer service poorly").

Moreover, defendants correctly point out that the statement does not present an exhaustive list of all the reasons for the growth. See, e.g., In Re Boston Technology, Inc. Securities Litigation, 8 F.Supp.2d at 69 ("paragraph B is not reasonably construed to attribute the shortfall to an exclusive cause, and it was therefore immaterial to the investment decision"). As noted by the court in Polaroid, "Statements discussing how some market factors (like mergers among retail drug chains) are affecting business are not false or misleading simply because they do not implicate other negative market influences as well." In Re Polaroid Corporation Securities Litigation, 134 F.Supp.2d 176, 185 (D.Mass. 2001). Thus, the omission of the extensive end of quarter discounting does not render the statement materially misleading. See Gross v. Summa Four, Inc., 93 F.3d at 992 (revealing one fact about a product does not require corporation to "reveal all others that, too, would be interesting, market-wise, but means only such others, if any, that are needed so that what was revealed would not be 'so incomplete as to

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mislead'")

The statement is also inactionable corporate puffery. See, e.g., Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d at 24 (classifying as puffery statement that "Our eleventh straight quarter of record revenues is the result of continued market demand for our enterprise network and data security solutions"). Indeed, it is strikingly similar to the following statement in Orton that the court considered puffery: "Although we are not immune to the weakening economy in the near-term, we feel confident that the combination of our motivated workforce, solid infrastructure and total commitment to product development which is intended to deliver a high return on investment for customers, positions us for long-term growth." Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 300 (discounting statement as puffery and not "material to any reasonable analysis of the company's prospects"). The court in Orton rejected the foregoing statement as puffery against the contention that the statement failed to disclose that "long-term growth was unlikely because of Parametric's improper recognition of revenue in earlier periods." Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 300. The other portions of the statement pertaining to the continuation of "momentum" and the company's "consistent quarter to quarter growth" is likewise mere puffery and sales talk. See, e.g., In Re Parametric Technology Corporation Securities Litigation, 300 F.Supp.2d at 220-221 (characterizing as puffery statements that company was "well

positioned for growth" and that it "expects more revenue growth in opportunities in Asia in the coming years").[56]

The same reasoning applies to the similar statements in the August 2, 2001 Bloomberg news article. When asked how Sullivan would increase or aggressively gain market share, Sullivan lists Cytyc's "unique sales and marketing strategy" as "creating the demand at the physician's office." (¶ 73). Although the complaint adequately pleads the time, place and content of the communication, the statement itself is not false or misleading. Like the July 25, 2001 statement, the list is not exhaustive or otherwise materially false or misleading. There is no indiction that the direct sales force was not creating, at least in part, the demand. In addition, the nondisclosure of the use of discounts did not significantly alter the total mix of information inasmuch as the 2000 Form 10-K filing discloses the use of such discounts. Alternatively, the self directed comment is puffery as is Sullivan's mildly optimistic prediction about the company's ability to maintain similar growth ("We believe so") (¶ 73).[57]

In the interview, however, Sullivan also quantifies revenue projections. (¶ 75). The quantification provides sufficient

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[56] As explained <u>infra</u> with respect to these and other statements, the omission of the deep discounting at Cytyc falls significantly short of reckless when placed in context and the complaint as a whole fails to demonstrate a strong inference of scienter.

[57] Like the July 25, 2001 comments, this court's decision obviates the need to address the applicability of the PSLRA's safe harbor provision to these comments.

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specificity to avoid defendants' assertions of puffery. Sullivan's revenue projections in the interview, bereft of cautionary language or a reference to document[s] identified as containing cautionary statements,[58] do not fall within the reach of the safe harbor provision or the bespeaks caution doctrine. See 15 U.S.C. § 78u-5(c)(2); H.R. Conf. Rep. No. 104-369, * 45 (1995) ("Companies who want to make a brief announcement of earnings or a new product would first have to identify the statement as forward-looking").

Contrary to defendants' position that the information does not alter the total mix of information, the forecast gives a specific range for 2002 revenues. Cf. Suna v. Bailey Corporation, 107 F.3d at 70 (discounting projections as not actionable in part because they "do not project specific numbers that the company will certainly attain"). Projections and the company's ability to meet financial targets are "certainly material to any sensible evaluation of [a] company's performance." Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 302. Theoretically, the projection was materially misleading when made because the preexisting and continuous deep discounting and over-stuffing of customers would prevent Cytyc from meeting the forecast. Existing revenue growth was achieved at the expense of future sales. (¶ 82).

The issue therefore devolves into whether Sullivan had

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[58] Instead, during the televised exchange Sullivan simply refers to a conference call.

information known to him at the time that would show that the anticipated or projected earnings for 2001[59] and/or 2002 were unlikely. See generally Suna v. Bailey Corporation, 107 F.3d at 70. This is where the complaint falters. First, the complaint fails to plead sufficient facts to support the information and belief that Sullivan knew that the projection was false when made. See 15 U.S.C. § 78u-4(b)(1). The facts alleged fail to adequately show that Sullivan had knowledge of specific facts regarding the channel stuffing and the magnitude or extent of the end of quarter discounting in August 2001 that would make Sullivan's projection unreasonable. See In Re Boston Technology, Inc. Securities Litigation, 8 F.Supp.2d at 54 ("Absent bad faith, a defendant must have had--at the time the statement was made--knowledge of specific facts making the statement unreasonable"); see also Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d at 361. Furthermore, under the facts alleged there is absolutely no bad faith or intentional deception reasonably inferred.

Sullivan also had no knowledge that the projection was materially misleading. See Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d at 361 (under Rule 9(b), "complaint must set forth 'specific facts that make it reasonable to believe that defendant[s] knew that a statement was materially false or misleading'"). To the contrary, there was little reason to

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[59] Cytyc met the 2001 projection. (¶¶ 96 & 115). This is true with respect to both the earnings projection on August 2, 2001 and on January 14, 2002.

believe that the failure to disclose the discounting was materially misleading and would alter the total mix of information inasmuch as the 2000 Form 10-K already disclosed the use of discounts. Similarly, there was no duty to disclose the discounting under the circumstances. The projection is therefore not actionable under the facts alleged.[60]

Sullivan's equally glowing repetition of 2002 projected earnings on January 14, 2002, as "approximately $0.64 to $0.66" (¶ 95) is not puffery but nonetheless fails for identical reasons. It is true that the complaint notes that the continuous channel stuffing was and would continue to have an adverse impact on future sales and/or the market share was overstated because of the channel stuffing, not to mention that customers were ceasing to do business with Cytyc because of such practices. (¶ 100). The complaint fails, however, to provide facts to support the information and belief regarding Sullivan's knowledge that the projection was false or misleading when made. In any event, the strong inference of scienter is notably absent.[61]

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[60] Alternatively, as discussed <u>infra</u>, there is an absence of a strong inference of scienter.

[61] The January 14, 2002 press release contains an adequate cautionary proviso that the projections are forward looking statements and sufficiently warns investors of the risks, including those identified in the 2000 Form 10-K filing. Consequently, although defendants neglect to expressly rely on the safe harbor provision or the bespeaks caution doctrine as applied to this statement, it is highly likely that the statement is not actionable. Given the absence of an explicit argument to this effect, however, this court rests its decision with respect to this statement on the conclusion that plaintiffs fail to plead a strong inference of scienter. Defendants present the scienter argument (as well as the corporate puffery, materiality and Rule

The October 19, 2001 comment by Sullivan that the company feels "confident in our success based on our track record" with ThinPrep is sales talk. See, e.g., In Re Parametric Technology Corporation Securities Litigation, 300 F.Supp.2d at 217 (statement that "we continue to have confidence in the fundamental strength of our business and in our strong competitive position" considered puffery); Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d at 24 (classifying as puffery statement that, "There are very few companies that are positioned as well as us and have the track record, the experience and the management"). Unaccompanied by any specifics regarding the company's "track record," see Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d at 24 (finding phrase "continued market demand" vague inasmuch as it failed to "specify a particular market demand [or] a market share figure"), no reasonable investor would consider the statement material to an investing decision.

For the same reasons that apply to the July 25, 2001 statement, the strikingly similar statement in the October 24, 2001 press release ("We believe the superior clinical performance of the ThinPrep Pap Test and the effectiveness of our sales and marketing strategy have provided Cytyc with consistent revenue and earnings growth and financial performance") is not actionable. The statement does not purport to identify all of

9(b)/PSLRA pleading shortcomings) universally as applied to all the allegations in the complaint. (Docket Entry # 31, § Introduction & § I(C)(2)).

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the factors effecting growth and performance. Alternatively, for reasons expressed with respect to the July 24, 2001 statement, the statement amounts to puffery. See, e.g., Suna v. Bailey Corporation, 107 F.3d at 70 ("While the company states that it *believes* [emphasis supplied] the opportunities will be comparable, the statement contains no promise to that effect").

Plaintiffs next challenge in a January 23, 2002 press release that Cytyc had "now reported fifteen consecutive quarters of revenue growth." (¶ 96). Although plaintiffs contend and plead that the statement is false because of the failure to disclose the channel stuffing which numerous former employees articulate, the statement was an accurate portrayal of past and present earnings. It was not false. Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d at 361 & n. 4 ("defendants may not be held liable under the securities laws for accurate reports of past successes, even if present circumstances are less rosy"). As to the misleading nature of the statement, defendants had no duty to disclose the channel stuffing with respect to this statement. The omitted disclosure of channel stuffing did not cause what Sullivan did say, to wit, 15 past quarters of growth, to be misleading. See Shaw v. Digital Equipment Corporation, 82 F.3d at 1212 ("reports of past successes do not themselves give rise to a duty to inform the market whenever present circumstances suggest that the future may bring a turn for the worse"). In contrast to a similar statement deemed actionable in Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 302 ("we met

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the third quarter targets we set in April"),[62] plaintiffs cannot, as explained supra, empirically show that Cytyc did not meet the earnings for the quarters in violation of the cited regulatory provisions and the company's revenue recognition policy. Cf. Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 302 (above statement actionable because, in theory, "the Purchasers could empirically disprove Harrison's statement by demonstrating that Parametric did not actually meet the financial targets set in April under GAAP and under the company's own accounting policies").

The remaining objectionable portion of the statement ("We believe the achievements of 2001 put Cytyc in a solid position to build on the momentum of the past year") is puffery. See, e.g., Suna v. Bailey Corporation, 107 F.3d at 70 ("While the company states that it *believes* [emphasis supplied] the opportunities will be comparable, the statement contains no promise to that effect"); Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 302 (after stating that company met the target for the April quarter, the further statement that "[s]olid execution of our cost reduction programs and consistent focus on our key initiatives will position us for enhanced earnings potential once the economy improves" was puffery); In Re Parametric Technology

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[62] Like the entire objectionable portions of the January 23, 2002 statement, the statement in Orton reads in full as follows: "[W]e met the third quarter targets we set in April . . . Solid execution of our cost reduction programs and consistent focus on our key initiatives will position us for enhanced earnings potential once the economy improves." Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 302.

Corporation Securities Litigation, 300 F.Supp.2d at 220-221 (characterizing as puffery statements that company was "well positioned for growth" and that it "expects more revenue growth in opportunities in Asia in the coming years"). Such general optimism regarding the elusive concept of "momentum" building for an indeterminable amount of time into the future is not actionable.

As already explained,[63] the forecast in the January 24, 2002 Bloomberg news interview ("$295 to $305 million" and earnings per share "of between 64 and 66 cents" for upcoming year) is not puffery but nonetheless fails to constitute an actionable statement.

Sullivan's additional statement that "we believe" that Cytyc could capture "100 percent of the market" is, to a large degree, so unrealistic that no reasonable investor would give it credence. Put another way, a reasonable investor would not consider such a prophesy material to an investing decision. It also amounts to inactionable corporate puffery. See, e.g., Suna v. Bailey Corporation, 107 F.3d at 70; Orton v. Parametric Technology Corporation, 344 F.Supp.2d at 302; In Re Parametric Technology Corporation Securities Litigation, 300 F.Supp.2d at 220-221. Alternatively, as explained in connection elsewhere, the statement is not actionable because of the absence of a strong inference of scienter.

Plaintiffs next identify various statements in the April 24,

[63] See footnote number 22.

2002 press release and conference call as actionable. The forward looking statements (see, e.g., ¶ 118; ¶ 119, 2002 revenues) fall easily within the parameters of the PSLRA's safe harbor.[64]

The historical recitation of earnings in the April 24, 2002 press release (¶ 117), without more, was not false.[65] The statement also did not give rise to a duty to disclose the deep discounts or channel stuffing and was therefore not misleading. The press release did not present the statement of past earnings as a basis to forecast future growth but, instead, advised that Cytyc management would discuss future expectations at the conference call. See Shaw v. Digital Equipment Corporation, 82 F.3d at 1212 ("reports of past successes do not themselves give rise to a duty to inform the market whenever present circumstances suggest that the future may bring a turn for the worse").

The tightening inventory statement is not actionable for a number of reasons. First, the statement (¶¶ 119 & 124) fails the so-called "entanglement test." Under this test, recently adopted by the First Circuit, "liability may attach to an analyst's statements where the defendants have expressly or impliedly adopted the statements, placed their imprimatur on the

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[64] See footnote 55.

[65] To the extent the market share (¶¶ 47, 68, 82, 90, 100, 102, 109 & 117) or conversion rate stated at various times in the complaint was not accurate (see, e.g., ¶ 127), there is an absence of a strong inference of scienter.

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statements, or have otherwise entangled themselves with the analysts to a significant degree." In Re Cabletron, 311 F.3d at 37-38; accord Stone & Webster, Inc. Securities Litigation, 253 F.Supp.2d at 113 (same).[66] Second, the conclusory assertions that defendants intended analysts to rely upon and repeat various statements (¶ 76), that the company provided guidance to analysts and that the company used analysts, as a conduit to provide false and misleading information (¶¶ 167-172) do not satisfy Rule 9(b). See Stone & Webster, Inc. Securities Litigation, 253 F.Supp.2d at 113 ("Suna also rejects the notion that general statements regarding a company's 'practice' of 'communicat[ing] regularly with securities analysts . . . and [of] provid[ing] detailed "guidance" to these analysts' are sufficiently particularized to survive a motion to dismiss" under Rule 9(b)). The article itself does not quote a company source or imply that Cytyc adopted the statements therein. See, e.g., Suna v. Bailey Corporation, 107 F.3d at 74 (rejecting under 9(b) allegation attributing statements to company inasmuch as "reports do not appear to quote any Bailey officer or employee, nor do they imply that the forecasts were supplied or confirmed by any Bailey officer or employee").

The assertion that Cytyc falsely represented in the conference call that the inventory problem manifested itself "only in the first quarter of 2002" (¶ 125) or that, as reflected

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[66] Plaintiffs' reliance on Stone & Webster (Docket Entry # 36, p. 30) is misplaced for reasons set forth in defendants' reply (Docket Entry # 39, pp. 13-14).

in a UBS Warburg report, the company "'instituted a one-time promotion'" (¶¶ 121 & 122) is belied by the transcript. See In Re Computervision Corporation Securities Litigation, 914 F.Supp. 717, 719 (D.Mass. 1996) (noting "fundamental and fatal defect[]" in securities fraud action that, with respect to the allegedly actionable statements, "the Company simply did not say what the plaintiffs say it said"). Sullivan explicitly stated that this was not the first time for company promotions. The 2000 and 2001 Forms 10-K also both note the use of "discounts" (plural) "[i]n the past." (Docket Entry # 32, Ex. B & J).

Having addressed various statements, this court turns to the issue of scienter or, more accurately, the absence thereof.

E. Scienter

Having already defined the concept of scienter, this court simply notes that there is no one fact pattern that predominates the calculus. Instead, the fact pattern presented in each individual case is analyzed to determine if the allegations are sufficient to support a strong inference of scienter. Geffron v. Micrion Corporation, 249 F.3d at 36 ("this Court does not 'categoriz[e] patterns of facts as acceptable or unacceptable to prove scienter,' but instead 'analyze[s] the particular facts alleged in each individual case to determine whether the allegations [are] sufficient to prove scienter'"); Greebel v. FTP Software, 194 F.3d at 196.

What consistently strikes this court in reading and rereading the complaint and other relevant and properly

considered documents is the absence of the strong inference of scienter now required under the PSLRA. First, there is nothing inherently wrong with discounts or pressing for sales to be made in earlier quarters or at the end of a quarter. Greebel v. FTP Software, 194 F.3d at 202 ("[t]here is nothing inherently improper in pressing for sales to be made earlier than in the normal course");[67] accord Johnson v. Tellabs, Inc., 262 F.Supp.2d 937, 950 (N.D.Ill. 2003) ("[i]n the business world, there certainly is nothing inherently wrong with offering incentives to customers to purchase products"). Nor is there any additional suggestion of inventory parking, contingent sales or other improper activity.[68]

Second, throughout the class period, the company's SEC filings disclosed the use of discounts, albeit not to the degree plaintiffs insist was necessary. Given the fact that Cytyc's public documents disclosed the use of discounts, i.e., the company's "channel stuffing practices," see In Re Segue Software,

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[67] There is nevertheless a line between offering discounts or encouraging earlier than normal sales versus knowingly hiding low earnings in the earlier quarters by artificially inflating revenues through improper revenue recognition. See Greebel v. FTP Software, 194 F.3d at 202; accord In Re Focus Enhancements, Inc. Securities Litigation, 309 F.Supp.2d at 149. The latter provides a weak inference of scienter. Greebel v. FTP Software, 194 F.3d at 202-203; accord In Re Focus Enhancements, Inc. Securities Litigation, 309 F.Supp.2d at 149-150. Given the absence of improper revenue recognition, even this weak inference is missing.

[68] The three cases outside this circuit prominently cited by plaintiffs (Docket Entry # 36, pp. 1-2) are distinguishable for reasons stated by defendants in their reply memorandum (Docket Entry # 39, pp. 3-4 & n. 2) and eloquently expressed at the hearing.

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Inc. Securities Litigation, 106 F.Supp.2d at 168 (allegation of improperly booking contingent sale to boost revenue and not disclosing the right of return in the large and identified million dollar sale to named customer not fraudulent given the Form 10-K disclosure);[69] see also Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d at 35-36 (finding list prices in Form 10-K not fraudulent inasmuch as the disclosure was made that the prices were "[s]ubject to volume discounts and other licensing terms and conditions"), the record fails to reflect a strong inference that defendants knew that the statements were false or materially misleading by omitting the information regarding the extent of the discounting at Cytyc. See Geffon v. Micrion Corporation, 249 F.3d at 36 ("[e]ven if the statements at issue were material and false or misleading, the evidence does not support a finding that defendants knew the statements would materially mislead the investing public"). Indeed, during the April 24, 2002 conference call, Sullivan forthrightly sought to provide investors with the information that this was not the first time the company had used promotions. See Geffon v.

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[69] Indeed, the disclosure in the Form 10-K in Segue was even less forthcoming that the ones in the case at bar. In Segue, the Form 10-K affirmatively stated the contrary, to wit, that, "The Company typically does not grant to its customers a contractual right to return software products." In Re Segue Software, Inc. Securities Litigation, 106 F.Supp.2d at 168. The form then gave the impression that rights of return were the exception and not contained in typical, if any, contracts with customers. The relevant language was that, "When approved by management, however, the Company has accepted returns of certain software products and has provided an allowance for those specific products." In Re Segue Software, Inc. Securities Litigation, 106 F.Supp.2d at 168.

Micrion Corporation, 249 F.3d at 37 (noting that "Micrion sought to provide investors with adequate warnings of the possibility that not all seventy-five units would be purchased").

Third, as already explained, the allegations of insider trading and revenue recognition or accounting violations lack merit. Although insider trading may provide evidence of scienter, see Greebel v. FTP Software, 194 F.3d at 196 (noting the "many different types of evidence as relevant to show scienter," including insider trading), the inference is nonexistent in the case at bar. Bowen never traded during the class period. Sullivan's trading was less during the class period than prior to or after the class period. Likewise and also as previously explained, violations of GAAP, SEC or company policy may give rise to an inference of scienter, see Aldridge v. A.T. Cross Corporation, 284 F.3d at 83 ("'accounting shenanigans' may be evidence of scienter"); In Re Cabletron, 311 F.3d at 39 ("[s]ignificant GAAP violations also 'could provide evidence of scienter'"); In Re Galileo Corporation Shareholders Litigation, 127 F.Supp.2d at 266 ("'a violation of a company's own policies supports an inference of scienter'"), but the record is devoid of any such violations.

Defendants' alleged motive to inflate the stock price and use the inflated price to purchase Pro-Duct and Digene at more attractive prices is unconvincing. See, e.g., In Re Galileo Corporation Shareholders Litigation, 127 F.Supp.2d at 270 ("the mere statement that an acquisition occurred after Galileo's stock

prices increased is insufficient even to create an inference that the two events were necessarily related, not to mention insufficient to create a strong inference either of an intent to deceive or of recklessness"). Sullivan and Bowen's involvement in discussing sales strategies, knowledge of daily activities, positions in the company, setting and encouraging unrealistic sales quotas, general access to internal information and/or focus upon the company's stock price (¶¶ 39-41, 46-47, 144, 147-151 & 153-154) are also equally unconvincing. See Carney v. Cambridge Technology Partners, Inc., 135 F.Supp.2d at 254 (rejecting "knowledge derived by Sims and Toscanini from unspecified plans, budgets, forecasts, reports, conversations, connections, meetings and 'other' information to which these defendants had access because of their positions with CTP" as adequate to plead scienter); Fitzer v. Security Dynamics Technologies, Inc., 119 F.Supp.2d at 25 (declining to "speculate that because former employees in the corporation knew of changes in the sales profiles, the corporate executives must also have known about the changes and fraudulently concealed them"); Lirette v. Shiva Corporation, 27 F.Supp.2d at 283 ("[a]ttempts to plead scienter by general allusions to unspecified internal corporate information are insufficient to withstand a motion to dismiss"); In Re Viewlogic Systems Securities Litigation, 1996 U.S.Dist. Lexis 22371 at * 37-39 (D.Mass. March 13, 1996); see also Maldonado v. Dominguez, 137 F.3d 1, 9-10 (1st Cir. 1998).

In sum, there is a marked void of the necessary strong

inference of scienter. Finally, lacking a predicate violation of section 10(b) of the Securities Exchange Act of 1934 or of Rule 10b-5, 17 C.F.R. § 240.10b-5, the section 20(a) claim is also subject to dismissal. See Suna v. Bailey, 107 F.3d at 72; In Re Parametric Technology Corporation Securities Litigation, 300 F.Supp.2d at 224.

Defendants seek a dismissal with prejudice. In a footnote, however, plaintiffs summarily request leave to replead in the event this court "determines that there are efficiencies in the Complaint as to any of the named defendants." (Docket Entry # 36, n. 26). This court assumes plaintiffs meant to use the word "deficiencies." As discussed, there are numerous deficiencies.

Although this case is rapidly approaching the three year mark, the PSLRA "stays all discovery, with certain narrow exceptions, during the pendency of any motion to dismiss." In Re Cabletron, 311 F.3d at 33. In analogous circumstances, the court in Guerra v. Teradyne, Inc., 2004 WL 1467065 (D.Mass. Jan. 16, 2004), recommended a dismissal without prejudice given the plaintiffs' footnote request for leave to replead. Accordingly, the recommendation will be to dismiss without prejudice subject to allowing plaintiffs an opportunity to replead if there are grounds for such an amendment consistent with the rulings made in this opinion.[70] See, e.g., Guerra v. Teradyne, Inc., 2004 WL

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[70] It is, of course, entirely in the province of the district judge as to the amount of time he wishes to allow plaintiffs to submit a motion to amend together with an attached proposed consolidated second amended complaint. In the event plaintiffs chose to file a motion for leave to amend, this court

1467065 at * 28 (D.Mass. Jan. 16, 2004) (refusing to dismiss case with prejudice inasmuch as the plaintiffs asked to be given leave to replead in a footnote if the court dismissed the complaint).

CONCLUSION

In accordance with the foregoing discussion, this court **RECOMMENDS**[71] that the motion to dismiss (Docket Entry # 30) be **ALLOWED** except to the extent that the dismissal be without prejudice subject to allowing plaintiffs an opportunity to replead consistent with the rulings made in this opinion.

/s/ Marianne B. Bowler
MARIANNE B. BOWLER
United States Magistrate Judge

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suggests that the proposed consolidated second amended complaint should clearly identify the newly added language and any omitted language.

[71] Any objections to this Report and Recommendation must be filed with the Clerk of Court within ten days of receipt of the Report and Recommendation to which objection is made and the basis for such objection. Any party may respond to another party's objections within ten days after service of the objections. Failure to file objections within the specified time waives the right to appeal the order. United States v. Escoboza Vega, 678 F.2d 378-379 (1st Cir. 1982); United States v. Valencia-Copete, 792 F.2d 4, 6 (1st Cir. 1986).